IN THE

Supreme Court of the United States

OCTOBER TERM, 1922.

No. 823.

FARMERS AND MERCHANTS BANK OF MONROE, N. C., ET AL., PETITIONERS,

vs.

FEDERAL RESERVE BANK OF RICHMOND, VA., RESPONDENT.

ON WRIT OF CERTIORARI TO REVIEW A JUDGMENT OF THE SUPREME COURT OF NORTH CAROLINA.

BRIEF FOR RESPONDENT.

This is a civil action, in nature of a suit in equity originally instituted in the Superior Court of Union County, North Carolina. The complainants are the Farmers and Merchants Bank of Monroe and certain

other state banks and trust companies of that state, which sue in behalf of themselves and other state banks and trust companies similarly situated. The respondent is the Federal Reserve Bank of Richmond, being one of the twelve Federal Reserve Banks established under the act of Congress, known as the Federal Reserve Act. For convenience, and in order to conform to the terms used in the record, the petitioners before this court will hereafter be referred to as the "complainants," and the respondent as the "defendant."

The object of the suit was to obtain an injunction restraining the Federal Reserve Bank of Richmond from returning as dishonored checks drawn on and presented to the respective complainants, for which exchange drafts were tendered in payment, and also to restrain said Federal Reserve Bank of Richmond from refusing to accept such exchange drafts when tendered in payment of said checks. In effect, the purpose of the suit was to restrain and prevent the defendant bank from applying the so-called "par-clearance" system in the collection of checks drawn upon the respective complainants not members of the Federal Reserve System.

Upon the filing of the complaint, the defendant, Federal Reserve Bank of Richmond, duly appeared and filed a petition for removal of the cause to the United States District Court for the Western District of North Carolina. After a hearing the Superior Court of Union County denied the petition for removal. Thereupon a certified copy of the record was duly filed in the Clerk's Office of the District Court of the United States, as provided by the statute, and removal was effected. The complainants then appeared in the United States District Court and moved to remand upon the ground, among others, that the controversy did not involve any matter in dispute capable of being estimated in money. (Rec., p. 24.) After the hearing the United States District Court remanded the cause to the Superior Court of

North Carolina for reasons stated in the opinion of the Judge. (Rec., pps. 26-29.)

The defendant thereupon appeared and filed its answer to the complaint. (Rec., pps. 29-44.) The cause came on in due course to be heard before the Superior Court of Union County, North Carolina, and the jury for the trial of questions of fact, as provided for by the practice of that state, having been duly waived by both parties, the cause was fully heard upon the facts and the law before the judge of that Court, and submitted on February 27, 1922. The court thereupon, after stating the issues in the case, made a finding upon the facts in writing, consisting of twenty-three paragraphs (Rec., pps. 54 to 62); and by these findings it expressly absolved the Federal Reserve Bank of Richmond from any intent to commit, and from the commission of any act intended to injure the complainants and from saving up or accumulating checks drawn upon the respective complainants, as alleged in the complaint. In its conclusions upon the law, the court sustained the contention of the complainants and entered its decree of injunction against the defendant substantially in accordance with the prayer of the complaint. From this decree an appeal was taken to the Supreme Court of North Carolina, which court, after a full hearing, reversed the decree of the Superior Court of Union County, and dissolved the injunction granted by that court, holding, in effect, that the statute of the state of North Carolina relied upon by complainants was unconstitutional, as being in conflict with the provisions of the Act of Congress, known as the Federal Reserve Act, and also in conflict with certain provisions of the Constitution of the United States, as will more fully appear by reference to said opinion in the record. Thereupon the complainants filed a petition for rehearing, which was granted. Additional briefs were filed in said court, and upon consideration thereof, the court adhered to its former decision reversing the decree of

the Superior Court of Union County, North Carolina, one judge dissenting, but assigning no reason for the dissent. Thereupon, complainants filed their petition in this court for a writ of *certiorari* to review said decision, and the defendant, feeling that the public interests required a speedy and final determination of the important questions involved, joined in the prayer for a writ of *certiorari*, which was accordingly granted by this court. The case is now before this court on that writ.

STATEMENT OF CASE.

The defendant, Federal Reserve Bank of Richmond, is a banking corporation duly organized and doing business under an act of Congress, known as the Federal Reserve Act of 1913 (38 Statutes at Large, 251), and amendments thereto. It is one of twelve such banks established for the twelve Federal Reserve districts provided by said act. The Fifth Federal Reserve District, which the defendant is organized to serve, consists of the states of Maryland, Virginia, North Carolina, South Carolina, a portion of the State of West Virginia, and the District of Columbia.

The capital stock of each of said Federal Reserve Banks is owned by the commercial banks of the district in which it is located, which are or may become members of the Federal Reserve System, each of said commercial banks being required, as a condition of its membership in said system, to subscribe for an amount of the stock of the Federal Reserve Bank of the district of its location equal in par value to six per cent of its capital and surplus, one-half of said subscription being required to be paid in cash and the remainder on call of the Federal Reserve Board. All earnings of the respective Federal Reserve Banks over and above the operating expenses, a provision for certain limited surplus, and six per cent per annum upon the paid-up capital stock are payable to the Government of the United States as a franchise tax.

Banks which are or may become members of the Federal Reserve System under said Federal Reserve Act and amendments thereto (hereinafter referred to as "Member Banks") are of two classes:

(a) National Banks within each district, all of which are required by law to be members of said Federal Reserve System;

(b) State banks and trust companies having the capital required by the terms of the act and otherwise qualified for membership, which voluntarily become members of said System.

In addition to the banks having full membership in said System, as aforesaid, non-member State banks and trust companies of each district are entitled to avail themselves of the collection and clearance facilities of the Federal Reserve System, by establishing and maintaining clearance accounts and carrying appropriate balances with the Federal Reserve Bank of the District in which they are located.

Each of the Federal Reserve Banks thus established, including the defendant, is managed and controlled by a board of directors of nine members selected in the manner provided in the act, and all of said Federal Reserve Banks are under the general supervision and direction of a board, known as the Federal Reserve Board, consisting of eight members, located at Washington, the members of said board being appointed by the President by and with the consent of the Senate.

The functions of the respective Federal Reserve Banks may be divided into two general classes:

(a) Public functions, in which the respective banks act as fiscal agencies of the Government of the United States, in such matters as the distribution of Government securities, receiving Government deposits required by law to be kept in said banks, paying pub-

lic obligations on proper orders, obtaining and issuing notes which serve as currency, and similar acts of a public character relating to the fiscal operations of the Government.

(b) Commercial or private banking functions, such as acting as reserve depositories for member banks which are required by law to keep their legal reserves in the Federal Reserve Banks; the purchase in the open market, or rediscount for member banks, of commercial paper; the making of loans to member banks on approved security, the collection of checks, drafts or notes, and acting as a clearance agency for member banks and for such non-member banks as avail themselves of these facilities by establishing clearance accounts, and other similar acts relating to commercial or private banking transactions.

For the purpose of facilitating collections and the clearance of balances between the several Federal Reserve Banks, a gold fund is maintained under the control of the Federal Reserve Board, through which the daily balances of the Federal Reserve Banks of the respective districts are cleared and settled.

As will hereinafter more fully appear, the issues in this case involve directly the exercise of the commercial functions of the Federal Reserve Banks, in the clearance and collection of checks, ~~drafts and notes~~, in the discharge of which duties they exercise functions common to all commercial banks, but indirectly the determination of these issues necessarily affects the successful exercise of both the public and the commercial or private functions of said banks.

By the Federal Reserve Act and its successive amendments, the Federal Reserve Banks were authorized to receive and collect all checks payable upon presentation within their respective districts, whether drawn on member or non-member banks.

Section 16 of the Federal Reserve Act provided that checks upon member banks should be received on deposit at par. By the latest amendment of Section 13, Congress declared that no charge for the payment of any check or the remission therefor by exchange or otherwise should be made against Federal Reserve Banks.

The Federal Reserve Bank of Richmond was advised that under these provisions of the law, it became its duty to receive all checks payable upon presentation within its district, and to collect such checks if it was possible to do so, but that it could not pay to the drawee any fee or charge for remitting for such checks. It was, however, advised that if the drawee refused to remit the full face amount of such checks, it was lawful and proper for the Federal Reserve Bank of Richmond to employ reliable agents in the towns where the drawee banks did business to present such checks to the drawee banks in due course of business and receive payment in lawful money, or properly protest any such checks, which after due presentation remained unpaid, which is the proper legal method for collection of checks by all banks.

Bank of Rocky Mount vs. *Floyd*, 142 N. C. 408.

The Federal Reserve Bank of Richmond accordingly notified all non-member banks in North Carolina that it would begin on November 5, 1920, to accept checks drawn upon them. If the non-member banks so desired, these checks would be sent to the bank by mail, in order that after examining them such bank could remit the amount due either by shipment of currency at the expense and risk of the Federal Reserve Bank, or at the option of the non-member bank by such a draft as the Federal Bank of Richmond could collect within one day following its receipt. The Federal Reserve Bank of Richmond would furnish a self-addressed, stamped envelope with each letter, containing checks, so that the remittance draft or advices of the shipment of currency

could be sent to it without expense. The non-member banks were also notified that if they did not wish to make this arrangement, the Federal Reserve Bank of Richmond would have proper agents present the checks upon the teller in the usual course of business so that they could be paid, or if not paid, protested in the manner prescribed by law.

Some of the state banks and trust companies of North Carolina, including certain of the complainants in this cause, objected to remitting at par, or to make payment in cash upon the presentation of their checks, and appealed to the Legislature of the state for relief against what they conceived to be an invasion of their rights. Thereupon the Legislature passed an Act (Chapter 20, Public Laws, 1919,) entitled "An act to Promote the Solvency of State Banks." This Act is the basis of the claim of the complainants in this suit, and for the convenience of the Court will be quoted in full. It is as follows:

Section 1. That for the purpose of providing for the solvency, protection and safety of banking institutions and trust companies chartered by this state and having their principal offices in this state, it shall be lawful for all banks and trust companies in this state to charge a fee not in excess of one-eighth of one per cent, on remittances covering checks, the minimum fee on any remittance therefor to be ten cents.

Section 2. That, in order to prevent accumulation of unnecessary amounts of currency in the vaults of the banks and trust companies chartered by this state, all checks drawn on said banks and trust companies shall, unless specified on the face thereof to the contrary by the maker or makers thereof, be payable at the option of the drawee bank, in exchange drawn on the reserve deposits of said drawee bank when any such check is presented by or through any Federal Reserve Bank, postoffice, or express company, or any respective agents thereof.

Section 3. That it shall be unlawful for any person, or persons, other than the maker thereof, to make, by rubber stamp or otherwise, any notation on any check drawn on any bank or trust company chartered in this state, the effect of which notation shall change or affect any condition or provision thereof, as created by this Act. That any person or persons violating this section shall be guilty of misdemeanor, and upon conviction shall pay a fine of not more than Two Hundred ($200.00) Dollars, or be imprisoned not more than thirty days.

Section 4. That all checks drawn on the banks and trust companies in this state in payment of obligations due the State of North Carolina or the Federal Government shall be exempt from the provisions of Sections 1 and 2 of this Act.

Section 5. That no officer in this state shall protest for non-payment any check or checks drawn on any bank or trust company chartered by this state, when payment is refused by the drawee bank solely on account of failure or refusal of the holder or owner thereof to pay exchange charges herein authorized; and there shall be no right of action, either in law or equity, against any bank or trust company chartered by this state, for refusal to pay any such check when such action is based alone on the ground of refusal to pay exchange or collection charges herein authorized.

Section 6. That all laws in conflict with the provisions of this Act are hereby repealed.

Section 7. That this Act shall be in full force and effect from and after its ratification.

The defendant was advised that this Act was invalid as being in violation of the Constitution and laws of the United States. It therefore notified the state banks in North Carolina that it would continue to collect checks at par in pursuance of the authority given by the Federal Reserve Act as amended, and in the event of the refusal of said banks, or any of them, to remit at par it would present the checks at the counter and demand payment

in cash, and in the event of non-payment it would be compelled to return said checks as dishonored.

Thereupon the complainants on behalf of themselves and other State banks and trust companies of North Carolina similar situated, filed their complaint in this cause, in which they set up the provision of the Act of the Legislature of North Carolina aforesaid, averred that the defendant refused to recognize or to be bound by said Act, and refused to accept in payment of the checks tendered drafts drawn on the reserve deposits of complainant banks, or to permit the deduction of exchange charges from the face amount of said checks, and that this action of the defendant would seriously impair the credit and threaten the solvency of the complainant banks. The bill prayed that the defendant be permanently restrained from carrying out its threat to refuse to except exchange drawn by plaintiffs on their reserve deposits in payment of checks presented, and to return such checks to the drawers thereof as dishonored because the complainants refused to pay the same in cash. (See Rec., pp. 2 to 7.) The only suggestion of improper conduct on the part of defendant other than refusal to recognize the provisions of said Act of the Legislature of North Carolina was contained in Section Eighth of said complaint, where it was suggested that the defendant would "save up checks" and present them as threatened in its letters attached to said bill of complaint.

In the answer of the defendant (Rec., pp. 29 to 44) it expressly denies that it had saved up, or that it was its purpose to save up, checks upon the complainants or any of them, and averred that where the complainants declined to remit in exchange at par, said checks had been and would be promptly presented at the counter of said banks for payment in cash. The answer further sets up the provisions of the Federal Reserve Act and the contention of defendant that the Act of the Legislature of North Carolina upon which complainants rely

was void as being in conflict with the Constitution and laws of the United States.

The trial court in its findings of fact in this case (Rec., pps. 60, 62), expressly found that the checks were presented as expeditiously as possible under all the circumstances "without permitting such checks to accumulate in the hands of defendant, and there was no saving up of checks drawn on the plaintiff, or either of them, by the defendant," and by section 23 of the findings (Rec., p. 62) it further found "that the acts and things done by defendant as shown herein were done and performed solely with the object and with the intent to discharge what the defendant was advised and believed to be its legal duties and obligations under the Act of Congress, and the said defendant was not actuated by any motive or purpose to cause any undue injury or loss to the plaintiff banks, or any of them." To these exceptions no exception was taken by the complainants. The Supreme Court of North Carolina, in disposing of this point, says:

> "The plaintiffs, however, in addition to the economic effect of the Federal statute which forbids the payment by the Reserve Bank of a charge for collection of checks, thus forcing, as they claim, all collection to be made through the Federal Reserve Bank, who can thus collect without charge, made the further allegation that the defendant was undertaking to coerce the non-member banks to abandon their right to charge for remitting for collections of checks upon them by saving up checks over a considerable period of time until they reached a large amount and then demanding them at the counter with the probable effect of driving the bank into liquidation.
>
> We need not consider this allegation, which was not only denied by the defendant but which the court has found as a fact to be untrue, and the plaintiffs have taken no exception to such finding. It would be unnecessary to notice this proposition, but that

such conduct was condemned by Mr. Justice Holmes in the case of *American Bank & Trust Co.* v. *Federal Bank of Atlanta*, opinion filed 16 May, 1921,. That decision was rendered upon a demurrer on which, of course, the court assumed that all the allegations of the bill and all reasonable inferences from them were true. The finding of fact on the trial in the present case, eliminated this question entirely from our consideration."

The case as presented to this court, therefore, presents no question as to the propriety of the conduct or methods pursued by the defendant. The sole question is one of difference as to the legal rights of the parties upon the facts found by the court below, that in discharging what it conceived to be its duties under the Federal Reserve Act in the collection of checks upon complainant banks, the defendant did not save up or accumulate checks, but acted with every consideration for the rights and convenience of the complainants, and was actuated by no motive to cause them injury or inconvenience. Upon this record all issues of fact and conduct are eliminated. The case presents clearly defined issues of law. The points thus presented may be briefly summarized as follows:

POINT I.

That under the provisions of Section 13 of the Federal Reserve Act as amended, the defendant, Federal Reserve Bank of Richmond was and is authorized and required to receive on deposit or for collection from its member banks, or solely for collection from non-member banks, any check upon any of the plaintiff banks, if such check is payable upon presentation, and to collect the same at par without allowing deduction for exchange or other charge.

POINT II.

That the Act of the Legislature of North Carolina (Chapter 20, Public Laws 1921) upon which complainants rely is

invalid in that it is in conflict with the valid Acts of Congress which are the Supreme Law of the land, and in its purpose and effect it seeks to limit and restrain a Federal Agency created by Congress in discharge of the duties and functions imposed upon it by Acts of Congress.

POINT III.

That the Act of the Legislature of North Carolina upon which complainants rely is invalid in that it violates the provisions of Article I Section 10 of the Constitution of the United States, which prohibits any state from making anything but gold and silver coin a legal tender in the payment of debts.

POINT IV.

That the Act of the Legislature of the State of North Carolina upon which complainants rely is invalid in that it seeks to deny to the defendant the equal protection of the laws, and to deprive defendant of liberty or property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

Each of the points thus presented will be discussed in the order named.

POINT I.

That under the provisions of Section 13 of the Federal Reserve Act as amended, the defendant, Federal Reserve Bank of Richmond was and is authorized and required to receive for deposit or for collection from its member banks, or solely for collection from non member banks, any check upon any of the plaintiff banks, if such check is payable upon presentation, and to collect the same at par without allowing deduction for exchange or other charge.

The discussion of this point involves a consideration and construction of the provisions of the Federal Reserve Act and amendments thereto, applicable to the issues in this case. Since it is an elementary rule that in the construction of any legislative act the conditions leading up to its enactment, and the evils sought to be remedied thereby, should be considered in arriving at the legislative intent, we conceive that a brief review of the development of our financial and banking system and the conditions prevailing at the time of the enactment of this statute, as they are presented in the record in this cause, will be helpful to the court.

1. *Historical development of the financial and banking systems leading up to the legislation involved in this case.*

Before the Revolution the various American Colonies were united by common allegiance to the Crown of Great Britain. Only British coin was then in circulation, and the Colonies had made but little progress in commercial and financial development. Internal commerce was largely carried on by barter of commodities, and in many Colonies some staple commodity was treated as the measure of value, and served in place of money. In some of the Colonies there were Colonial banks, which issued notes ~~of a limited circulation~~, but these notes

were viewed by many with suspicion, and had little, if any, circulation beyond the neighborhood of the bank of issue.

During the War of the Revolution various states, acting as independent sovereignities, undertook to coin their own money, when metal for coinage was available, and issued bills of credit intended to circulate as money. The Continental Congress also issued large quantities of bills of credit. The close of the War of the Revolution found the Confederation victorious in battle, but bankrupt in financial resources and flooded with various forms of worthless paper currency. In an effort to establish credit and to foster home industries various states resorted to many different forms of regulation and taxation of commerce between themselves and other states. The demoralized conditions resulting from these varying regulations, and lack of uniformity and stability in the financial and monetary systems of the country were among the chief reasons for calling a convention to frame a plan for a more perfect union, which resulted in the adoption of the Constitution of the United States.

One of the chief powers granted by the Federal Constitution was the power to regulate commerce between the several states and with foreign nations and Indian tribes. The framers of the Constitution apparently realized that a uniform regulation of commerce would prove ineffectual unless there was likewise a uniform medium of exchange and measure of value, for there can be no stable commercial relations unless both buyer and seller know what the one will be required to pay and the other required to receive. Therefore, in order to carry out one of the basic purposes for which the Constitution was adopted, the framers of that instrument bestowed upon Congress, and upon Congress alone, the power to coin money and to regulate the value thereof. prohibited any state from emitting bills of credit—that is to say, notes intended to circulate as money; provided

that no state should make anything legal tender for debts, except gold or silver, and that no state should pass any law impairing the obligation of a contract; and gave to Congress power to enact uniform laws concerning bankruptcy. The combined purposes of these provisions evidently was that there should be an uniform commercial system, that there should be one money for all the states, and that any person having any debt due to him anywhere within the United States might know that his right to collect this debt might not be taken away, except by National law, and the monetary medium in which the debt should be discharged would be the same, regardless of where or by whom it was payable.

Then, as now, there was not a sufficient stock of bullion in the country to make possible the use of coin as the sole medium of exchange. The difficulty of transporting coin made it a most inconvenient medium for use in ordinary transactions. Therefore, early in the history of the United States the need was realized for some form of paper currency, but students of finance clearly perceived that in order to attain one of the main purposes of the Constitution this paper currency must be issued under Federal authority and be, like metallic money, of uniform value throughout the country.

One of the first important acts of the Federal Government was the organization of the Bank of the United States, having power to issue notes redeemable at any of its branches scattered through the various states. This afforded a paper currency redeemable in lawful money, without discount and without delay, and the adjustment of accounts between the branches of the Bank of the United States reduced to a minimum the necessity of transporting actual coin from place to place. The first Bank of the United States appears to have served its purpose so well that shortly after its charter expired it was seen, and emphasized by experience in the War of 1812), that the country could not dispense with the services which this bank had rendered, and the charter of

the second Bank of the United States was granted by a Congress which was then controlled by the Democratic-Republican party, even though many of the leaders of this party had at the beginning questioned the authority of the Federal Government to create National banks.

The second Bank of the United States (whether by reason of abuse of power by its officers or on account of political agitation it is unnecessary here to consider) incurred the opposition of many of the leading people of the country. In the great cases of *Osborne* v. *Bank* and *McCulloch* v. *Maryland*, Chief Justice Marshall sustained the power of Congress to charter a bank, and in the course of his opinion in those cases traced the reasons for the existence of a National bank, showing that it was a most convenient, if not an absolutely necessary agency by which Congress might carry out many of the important functions entrusted to it—not the least of which was its control over the monetary system of the Nation.

Opposition to the bank continued, and finally President Jackson diverted from it the deposits of Government money. The withdrawal of this support rendered its successful operation impossible.

The fall of the second National bank left the currency system of the country to the control of state institutions, in fact if not in law. As stated above, actual coin, because of its scarcity and bulk, could not be used in daily transactions among the public at large, and, therefore, the people of the country had of necessity to rely upon bank notes issued by various state banks. This situation defeated in spirit, if not in letter, the provisions of the Constitution and left each state with a currency issued by local State banks, which generally would not circulate beyond the borders of the state, or if it could be passed at all outside of the locality, was subject to severe fluctuation and discount. It is interesting to observe that many able students of the Constitu-

tion held that the provision in the Constitution, which forbade the states to emit bills of credit, by necessary implication prohibited the incorporation by the state of a bank of issue, and this was thought to be especially true if the state attempted in any way, directly or indirectly, to lend its own credit to such notes.

In the case of *Briscoe* v. *Bank*, 11 Peters 257, the majority of the court sustained the right of a state to authorize a corporation created by it to issue notes intended to circulate as money, but in upholding this right the court was careful to point out that in so doing the bank is serving a private and not a public purpose, and its notes are merely the obligation of the corporation which issued them, and, therefore, cannot have the legal quality of money. In this case Justice Story delivered a dissenting opinion, holding that the issuance by a bank in which a state was interested, either as a stockholder or as an incorporator, of notes intended to circulate as money, was a violation of the constitutional prohibition against the emission of bills of credit. In his opinion Mr. Justice Story states that Chief Justice Marshall concurred in the views therein expressed. This dissenting opinion shows how strongly the foremost expounders of our Constitution felt that the intent of that instrument was to provide for a currency system which should be National rather than local, and that anything which might, directly, or indirectly, interfere with such a result was in conflict with the Constitution.

During the period between the administration of Andrew Jackson and the War Between the States the number of State banks of issue greatly multiplied and their notes became the currency of the country. There were, therefore, two distinct media of exchange issued under different authority—that is, State bank notes, which circulated at par only in the state or immediate vicinity of the bank which issued them; and coin issued by the United States, which was the lawful money of the

country, but which, from its nature, was inconvenient in daily and general use.

It was largely as a result of these conditions that the custom of charging exchange for remittances in payment of checks was developed. The transportation of coin from one section of the country to another was slow and expensive. Shipment of bank notes was impracticable, for the reason that notes current in one state would not pass in another, or if they would pass at all it was only at a discount varying with the distance from and reputation of the bank of issue. If, therefore, a merchant in an outlying district desired to remit for a debt due in New York, he could not send currency which was in ordinary circulation in his own community. He was compelled to ship either gold or silver, submitting to the delay, loss of interest and expense incident to the transportation then prevailing and the possibility of robbery and considerable loss in abrasion; or to effect a remittance by purchasing a bank draft payable in New York. He was, therefore, compelled to go to his local bank, turn in bank notes, and with them purchase a draft drawn by this bank on some correspondent in New York, and send this draft in settlement of his debt. To meet the demand for such remittances, the banks maintained accounts with other banks in commercial centers. Under normal laws of trade the balance of exchange varied with the seasons of the year and the commercial conditions prevailing. Outlying banks would at certain seasons have a balance in their favor, and at other seasons the balance would be against them. These balances were adjusted by loans or by shipments of coin to cover the balances as in the case of international exchange.

Under conditions of transportation and communication then prevailing, balances maintained for the purposes aforesaid in distant banks and commercial centers could not be carried as a part of a bank reserve, since

it might be weeks before such funds could be made available in event of an emergency. A bank's reserves were, therefore, kept in its own vaults and the balances maintained in other centers were regarded as investments, against which drafts could be drawn and sold as demanded. Under conditions then prevailing, the maintenance of these balances in distant cities involved considerable loss and expense to the outlying banks. They were deprived of the use of these funds save for exchange purposes, and were compelled to transfer coin—the only money of general circulation—at heavy cost and risk, with a loss of interest and loss by abrasion while in transit. These and other items of loss and expense were necessary for the maintenance of balances against which drafts could be drawn, and it was but right that the local banks should demand a premium when selling their exchange drafts.

If a customer of a local bank instead of purchasing a draft from his bank upon its exchange balances and sending the same in payment of his debt due in a commercial center as indicated above, elected to send his own check on funds on deposit with his local bank, the result to the bank was exactly the same. The check was deposited by the payee with his bank in the commercial center for collection, and was sent in due course directly or through correspondent banks to the drawee bank for payment. That bank was then required either to send its exchange draft on its central deposits in settlement, or to remit coin. A proper and reasonable charge to cover this service and the loss and expense incident thereto under the prevailing conditions was entirely legitimate.

It is obvious that these exchange charges constituted a heavy burden upon the commerce of the country, but they were a necessary consequence of the imperfect currency system and the primitive means of transportation and communication which existed at that time.

As a result of the revolution in the methods of transportation and communication during the latter half of the Nineteenth century, there was a profound change in the political and economic development of the country, which was reflected in the national policy with respect to our currency and financial system. The conditions arising out of the war emphasized the necessity for returning to the original plan of the framers of the Constitution, and giving to the entire country a single uniform system of coinage and currency. Under the national banking act adopted during the War Between the States, the national banks were authorized to issue notes based upon United States bonds, and these notes were made receivable at par by the national banks and for all public dues except duties upon imports, and redeemable in lawful money at the Treasury of the United States, The Federal government had itself during the war issued circulating notes commonly called "Green Backs," which notes were by law made legal tender for debts. The Supreme Court of the United States sustained the right of Congress to make these notes legal tender in the Legal Tender Cases, 110 U. S. 421 and 12 Wall. 457, resting its decision partly upon the ground that the framers of the Constitution intended that Congress should regulate the monetary system of the country, and this necessarily implied the power in Congress to authorize the issue of paper money as well as specie. This gave to the country two classes of currency of universal circulation, namely, the Treasury Notes or "Green Backs" issued by the Government and National Bank notes issued by the National Banks under authority of the United States. A tax was laid upon the issue of notes by State banks, which practically prohibited the issue and circulation of such notes, and this tax was sustained by the Supreme Court in the case of *Veazie Bank* vs. *Fenno*, 8 Wall. 533.

The result of these various measures was to give to

the country an uniform system of national paper currency. The Supreme Court of the United States has recognized that this was the purpose of the national banking act and kindred acts referred to, in various cases, among others the case of *Talbot* vs. *Silver Bow County*, 139 U. S. 438, where the court said:

> "These various provisions, scattered through the entire body of the statutes respecting national banks, emphasize that which the character of the system implies an intent to create a national banking system co-extensive with the territorial limits of the United States, and with uniform operation within those limits to establish everywhere throughout the United States and furnish a currency of uniform value, the same in Arizona as in New York, in Territory as in State."

The establishment of a uniform system of paper currency which upon the resumption by the treasury of specie payment became receivable at par as the equivalent of gold and silver throughout the country, in connection with the rapid development of means of transportation and communication by railroad and telegraph gradually accomplished a complete transformation in the method of handling commercial and financial transactions and the conditions controlling the same. It eliminated the necessity for the shipment of coin, since paper money could be used in the payment of debts, and could be transported with greater convenience at less cost. It greatly reduced the necessity for shipments of currency, since transfers of credit could be promptly made by telegraph, and where shipments of currency were necessary the cost thereof was reduced, and the movement greatly facilitated.

As a consequence of these conditions it became possible for the outlying banks to keep large portions of their reserve in their correspondent banks in commercial centers and reserve cities, since these could be made

promptly available in an emergency, instead of keeping these reserves in their vaults. The reserve deposits so maintained thus became a source of profit to the banks, since the depositing banks were allowed interest thereon; and could be also used as a basis for exchange transactions. The system gradually developed to a point that banks were allowed to carry as a part of their reserve, not only the actual sums on deposit at commercial or reserve centers, but also checks forwarded to such reserve banks for deposit from the date on which the same were forwarded. This was obviously unsound banking, since it permitted a bank to carry as reserve checks in float and choses in action against other banks, but it greatly facilitated banking transactions and operated to the advantage of the outlying banks. This system of reserves continued until the enactment of the Federal Reserve Act in 1913, and still prevails to some extent among banks not members of the Federal Reserve System.

These conditions also led to an enormous development in the use of personal checks in the payment of distant obligations, instead of purchase of bank drafts for exchange. The depositor in a local bank maintained a checking account and sent his own personal check upon this account to a distant city in payment of his obligations, instead of purchasing a draft from his bank and forwarding the same in discharge of such obligations.

The increasing and universal use of such personal checks led to the necessity for the development of some system for the collection of same by the banks in which they might be deposited. Usually a bank in one center would arrange with a correspondent bank in another center to collect checks on banks in the community which such correspondent bank regularly served. As between the banks in the commercial centers, these checks were usually credited at par. In the normal run of business the clearings between centers were approximately bal-

anced except during periods of seasonal fluctuation, at which time adverse balances were discharged by shipments of currency or the negotiation of temporary loans. When checks were sent by city correspondents to country banks for payment they were paid by draft by the country bank on its reserve deposit with its city correspondent. The country banks maintained their balances with the city correspondent by sending in for collection checks on various parts of the country deposited with such country banks, which checks were usually collected by city correspondents at par, and the proceeds carried as part of the reserve of the country bank.

It will be observed that the conditions out of which arose the necessity for exchange charges in the early history of the country had now been largely eliminated by the establishment of an universal system of national currency, and by improvements in methods of transportation and communication. Yet the outlying banks continued in many instances to make charges of exchange for remittances in payment of checks.

This method of collecting checks led to a system of indirect routing, which resulted in considerable loss and inconvenience to the commercial interests of the country. It is obviously to the interest of the business community that checks should be collected as promptly as possible, since the owner of the funds represented by the check may lose the interest on such funds during the period of collection or float, and the risk of loss is increased by the delay. In fact, the law of negotiable instruments requires that the holder of the check must present the same for payment as speedily as possible or take the consequence of releasing the drawer or endorser thereof. The method of collecting checks through correspondents established by various banks throughout the country led to the indirect routing of these checks from the bank of original deposit by the payee thereof to the bank of collection.

In an effort to eliminate these conditions as far as practicable, and to relieve the commerce of the country of the enormous burden of exchange charges, the banks gradually developed a system of clearing house associations through which checks were cleared among the members of such clearing house associations at par, making necessary only the settlement of debit balances. These clearing house associations were originally confined to the commercial centers, but they were gradually extended in some sections of the country to embrace the country districts served by the banks of such centers. These country clearing house associations differed from the original organizations in the commercial centers, in that they did not effect exchanges only between their own members, but undertook to collect on behalf of member banks checks upon all banks within a prescribed radius. The best known examples of these were the country clearing house associations of Boston and Kansas City, but the system was being extended to other sections of the country at the time the Federal Reserve Banks were authorized to act as clearing houses for their members and took over the functions of these organizations.

These associations could, however, in the nature of things, only operate in a limited area, and as to the great bulk of the country the method of collection through correspondents and indirect routing which has been outlined, with charges of exchange for remittances in payment of checks by country banks continued in vogue.

Such, in a general way, were the conditions which prevailed at the time of the enactment of the Federal Reserve Act of 1913.

Some of the purposes sought to be attained and the results secured by that act may be briefly summarized as follows:

(a) The national currency system was greatly

broadened and made capable of ready expansion or contraction in response to the commercial needs and financial requirements of the country.

(b) The conditions as to banking reserves of the country were greatly improved by the elimination of fictitious reserves represented by checks in transit to reserve deposits and the concentration of banking reserves in the Federal Reserve Banks where they could be immediately and effectively used in event of an emergency.

(c) It provided a means of eliminating the waste, delay and loss incident to the indirect routing of checks for collection by providing for the clearing of checks on or for all banks through one channel.

(d) It eliminated the necessity for the maintenance by banks of enormous deposits in commercial centers to protect check collections on them, since it contemplated that all checks ~~for collection~~ should be presented through the Federal Reserve Bank of the district in which the reserve deposits of such banks are kept. It gave to local banks in the country districts, which had heretofore been dependent upon their correspondents for the collection of checks on other sections upon such terms as said correspondents might impose, the benefit of an universal par collection system through the Federal Reserve Banks, and thus eliminated the reason and necessity for exchange charges, and relieved the business interests of the small towns and rural communities of the heavy burden imposed by such exchange charges operating as a severe discrimination against them in competition with commercial centers in which such charges were not made. The importance of the removal of this burden from the business of local communities may be appreciated when the amount of such exchange charges accruing in any year is considered. In competition with mail order

houses and with large business communities, such charges might readily represent the difference between success and failure.

(c) While the complete inauguration of this system would deprive the country banks of the exchange charges which they had heretofore realized, this loss would be more than offset by the promptness with which their checks could be collected, the benefits of an universal par exchange in collection of their own checks, and by the commercial advantage gained for the communities which they serve through the fact that they were relieved of the discriminating burden of exchange on commercial transactions.

This general review of the historical development of the commercial and banking systems of this country leading up to the enactment of the Federal Reserve Act and amendments thereto shows that there have been four distinct periods in our financial and commercial history.

The first period was that from the foundation of the Federal Government down to the termination of the second bank of the United States. During this period the national policy with regard to our currency system contemplated by the Constitution, inaugurated by Hamilton and sustained by Chief Justice Marshall in his great opinions on this subject, prevailed.

The second period extended from 1835 to the Civil War. During this period there was a reaction toward local or state control or supremacy in both political and financial affairs. This was the period of state banks of issue and of local currency having only a very limited circulation.

The third period extended from the close of the Civil War to the enactment of the Federal Reserve Act in 1913. It witnessed a strong reaction to the national system of currency and national control of financial trans-

actions. The machinery provided by the legislation of this period proved utterly inadequate for the expanded commercial business of the country during the latter years in which it was in vogue. It proved defective in many particulars, some of which have been pointed out.

The fourth period begins with the enactment of the Federal Reserve Act. It is characterized by a distinct expansion of national control over our currency and banking transactions and a clear intent on the part of Congress to free the commerce of the country from unnecessary restraint, and to make the machinery of our financial organization adequate to meet the expanding business of the country and adapt it to modern means of transportation and communication. To do this as we have pointed out it was absolutely necessary not only to provide an elastic currency system, but also to provide for a proper concentration of the banking reserves in a few institutions like the Federal Reserve Banks, and also to provide a system for check clearances at par throughout the United States, which would relieve the smaller communities and rural districts of the burden of exchange charges then imposed upon them by the prevailing methods, and as an offset to the loss which the local banks might thus sustain, giving to those banks the benefit of an universal clearance system for the prompt collection of checks through fixed and definite agencies.

2. *The true construction of Section 13 of the Federal Reserve Act as Amended.*

In a consideration of the language of this section of the act, in the light of the circumstances reviewed, in order to arrive at the true meaning and intent thereof, it seems desirable to examine the original act, and the purpose and effect of the several amendments.

(a) *The scope and effect of Section 13 as originally enacted.*

Under this section as originally enacted, the respective Federal Reserve Banks were authorized,

(1) to receive *on deposit* from (a) member banks, and (b) the United States, checks and drafts upon solvent *member banks*, payable upon presentation, and

(2) solely for the purpose of exchange to receive from other Federal Reserve Banks deposits of checks and drafts upon (a) solvent member banks, or (b) other Federal Reserve Banks, payable upon presentation.

The authority of the Federal Reserve Bank was thus limited in the original act to receiving for deposit, and thereafter for collection in due course checks and drafts drawn on banks which were members of the Federal Reserve System, and ~~from~~ upon other Federal Reserve Banks. This enabled member banks of the Federal Reserve System to collect checks on other member banks in their district through the central agency of the Federal Reserve Bank of that district, and to collect checks on member banks of another district, through the Federal Reserve Bank, and thus to establish a system for direct and prompt clearance and collection of checks among member banks throughout the country, through the agency of the respective Federal Reserve Banks of the several districts, which in turn cleared their daily balances thorugh a central gold fund held for their account in the Treasury at Washington, thus avoiding the shipment of currency.

The system of par collection among member banks thus sought to be established soon developed certain practical difficulties. Non-member banks could not collect through the Federal Reserve Banks direct, since the Federal Reserve Banks could only receive checks on deposit from member banks of other Federal Reserve Banks, but such non-member banks could collect through

member banks with which they maintained accounts. These member banks would thus collect items for non-member banks drawn on other member banks at par, but when the process was reversed and member banks sought to collect checks drawn on non-member banks, an exchange charge for remission was made by such non-member drawee banks. This resulted in a serious discrimination to the disadvantage of member banks.

(b) *Federal Reserve Banks authorized to handle checks on non-member banks without restriction as to exchange charges by Act of Sept. 7th, 1916.*

To meet this difficulty, Section 13 of the Federal Reserve Act was amended by Act of September 7, 1916 (39 Statutes, 752), so as to authorize any Federal Reserve Bank to receive

(1) from any of its member banks *on deposit or for collection* checks drawn on both member and non-member banks within its district, and

(2) from other Federal Reserve Banks *solely for collection* checks ~~payable upon presentation~~, drawn on either member or non-member banks within its district.

This amendment clearly authorized the Federal Reserve Bank to receive any check payable, upon presentation, within its district, regardless of the bank upon which it was drawn, or whether the drawee was a member or non-member bank. If it was drawn on a member bank it would be collected at par through the agency of the Federal Reserve System. If it was drawn on a non-member bank, the Federal Reserve Bank, on receiving the same, had the same rights, and was subject to the same duties with respect to the collection thereof as any other holder of a check in due course for collection.

A check is an unconditional order upon a bank or

banker to pay to a specified person or to his order or to bearer a certain sum of money. The holder has no right of action against the drawee until it is presented. If, upon presentation, it is accepted by the drawee bank, then the right of the holder is to receive lawful money therefor, or if acceptance or payment is refused, the duty of the holder is to give notice of the dishonor of the check, and look for reimbursement to the person from whom the check was received.

Under the provisions of this section, as thus amended, taken in connection with Section 16 of the Act, it is clear that checks on member banks were required to be received at par and cleared or collected at par, but the law was silent as concerned checks upon non-member banks received by the Federal Reserve Bank for collection, as provided by this section as amended. The Federal Reserve Bank as to such checks drawn on non-member banks within its district was in the position of any other holder of a check. It could contract with the drawee bank for the presentation of said check through the mail, and remittance by mail, but there was no obligation upon the drawee bank to remit by mail, its obligation being limited to the payment of the check upon presentation at the counter. If, therefore, the drawee bank was asked to remit by mail, not being a member of the Federal Reserve System, it was free under this statute as it then stood to ask the Federal Reserve Bank in consideration of the remittance by mail to allow some discount or deduction from the face of the checks paid and to accept its draft upon reserve deposits in some other bank.

The Federal Reserve Bank, as the holder of the check, then had the option either to accept these terms, in order to secure remittance by mail, or to present the check at the counter of the drawee bank and receive cash therefor. The authority and power of the Federal Reserve Bank to receive for collection and to collect checks

upon non-member banks within its district was clearly established by this statute as thus amended, subject to the conditions controlling the collection thereof, which we have outlined, and which applied to the Federal Reserve Bank under the statute as it then stood exactly as they applied to any other banking institution engaged in the collection of checks.

It was found, however, that this amendment to Section 13, while it eliminated some of the practical difficulties which arose under the operation of the original statute, did not completely provide for all conditions necessary to establish a universal par-clearance system, which it was the obvious purpose of Congress to establish under this act. The act as it was thus amended further presented certain practical difficulties in operation. While it authorized the Federal Reserve Banks to receive for collection and to collect checks and drafts drawn upon non-member banks as well as member banks within their respective districts, and thus gave them the general power of collecting checks, it made no provision for enabling the non-member banks to avail themselves of the Federal Reserve collection system if they so desired. This left the non-member banks in this position—while they must pay checks handled through the Federal Reserve Banks, if presented to them, when it came to collecting checks held by them on member banks or non-member banks either within or without the district, they would be compelled, in order to have the checks collected through the Federal Reserve System, to maintain reserve deposit accounts with member banks through which such collection could be made. This gave rise to the possibility that terms might be imposed with respect to deposits as a condition of collecting such checks, which would be unfair to the non-member banks. On the other hand, while member banks were required to pay their checks at par when presented through the Federal Reserve Bank, there was nothing in

the law as it then stood to prevent the Federal Reserve Bank from entering into an arrangement with non-member banks for allowance of exchange or charge for remittance as a condition of remitting by mail instead of presenting the check at the counter and demanding payment, which was the legal right of the Federal Reserve Bank as holder thereof. This opened the doors for discrimination between member and non-member banks unfavorable to the member banks.

(c) *Purposes of Act of June 21st, 1917, which prohibits exchange charges against Federal Reserve Banks.*

To remedy this condition and thus perfect the law on the subject, Section 13 of the act was further amended by the act of June 21, 1917 (40 Statutes 235). This amendment added to the statute, as it then stood, the provision authorizing any Federal Reserve Bank "solely for the purpose of exchange or of collection" to receive from any non-member bank or trust company a deposit of current funds in lawful money, national bank notes, Federal Reserve notes, *checks and drafts payable upon presentation or maturing notes and bills*, provided that such non-member bank or trust company should maintain with the Federal Reserve Bank of its district a balance sufficient to off-set the items in transit held for its account by the Federal Reserve Bank. The amendment contained a further proviso that nothing in the section of the act should be construed as preventing member or non-member banks from making reasonable charges, to be determined and regulated by the Federal Reserve Board, but in no case to exceed ten cents for one hundred dollars or fraction thereof, based on the total of checks and drafts presented at any one time for collection or payment, for collection or payment of checks and drafts and remittance therefor by exchange or otherwise, but expressly provided that "no such charges shall be made against the Federal Reserve Bank".

As a result of this amendment the conditions indicated above were remedied. The non-member banks were given the option to collect through the Federal Reserve Banks, provided they maintained with those banks sufficient deposits to cover items in transit, and on the other hand, the possibility of discrimination between member banks, which were required to remit at par, and non-member banks, as to which, under the section as amended on September 7, 1916, there was no specific provision on this subject, was removed by adding to the section the express provision that no charge for the payment of checks and remission therefor by exchange or otherwise, "shall be made against the Federal Reserve Banks".

By this section as thus developed and amended, complete and adequate provision was made for the universal par-clearance and collection of checks in the United States through the Federal Reserve Bank.

That the authority now existed in the Federal Reserve Banks to establish a universal system for par-clearance and collection of checks, would seem to be too clear for serious controversy. But it is submitted that this act not only gave the banks the authority to establish such a system, but required that they should do so, in the interest of the public at large.

The collection of checks at par is a valuable service, which the Federal Reserve Banks are authorized to render their member banks, and also, under the act as amended to non-member banks, if the latter desire to avail themselves of the privileges of the collection system. It is a valuable service to the public. The record in this case shows that a charge of one-tenth of one per cent upon intra district clearances made by the Federal Reserve Bank for the year 1919 would have amounted to $135,000,000. The losses incident to the delays and inconvenience of circuitous routing of checks through many banks under the older system, were, per-

haps, even more serious. By this system of par clearances this burden upon the commerce and industry of the country is eliminated.

¶t is an elementary principle in the construction of statutes that where power is given to public officers or institutions for the benefit of the public or of individuals, the language, though permissive, must be construed as mandatory and the power so given must be exercised in the interests of the individuals or the public for whose benefit it is conferred. This rule is well stated in the case of *Supervisors* v. *United States*, 4 Wall. 435, p. 446, in which this court construed the words "may, if deemed advisable" as mandatory, and stated the principle as follows:

> "The conclusion to be deducted from the authorities is that where power is given to public officers, in the language of the act before us,—or in equivalent language—whenever the public interest or individual rights call for its exercise the language used, though permissive in form, is in fact peremptory. What they are empowered to do for a third person the law requires shall be done. The power is given not for their benefit, but for his * * * In all such cases it is held that the intent of the legislature, which is the test, was not to devolve a mere discretion, but to impose a positive and absolute duty."

In the case of *Hogg* v. *City Council of Camden*, 39 N. J. Law 620, 622, the court, in construing a city charter authorizing the city to sell land for taxes, stated:

> "The power conferred must be exercised. It is a settled construction that where a public or municipal corporation or body is invested with power to do an act which the public interest requires to be done, and has the means of its complete performance placed at its disposal, not only the execution but the proper execution of the power may be insisted on as a duty, though the statute conferring it be only permissive in terms."

See also

Terre Haute &c. Co. v. *Indiana*, 194 U. S. 579;
Turner v. *Smith*, 18 Grat. 830;
Pensacola v. *Lehman*, 57 Fed. 324;
Clark v. *City of Elizabeth*, 61 N. J. Eq. 565;
Davidson v. *Davidson*, 17 N. J. Eq. 169.

Applying this familiar principle to the case at bar, it is clear that the language of Section 13 of the act, taken in connection with the entire statute and the purpose and intent thereof, required the Federal Reserve Bank in the interests of the banking system, and the public at large to exercise this authority, and to put into effect a universal system for the collection of checks at par, that is, without any charge being made against the Federal Reserve Bank for the remission or payment thereof.

Being thus vested with this authority and charged with this duty and obligation, the defendant, Federal Reserve Bank of the Fifth District had no alternative but to endeavor to put into effect this system with the least possible embarrassment or inconvenience to the banks concerned from the resulting change in the method of doing business as to those banks which had theretofore charged exchange for the payment of checks. As to the bank members of the system, whether national or state, this presented no difficulty, as these banks could be and were required to remit at par. As to the non-member banks, the Federal Reserve Bank as the holder or the agent of the checks drawn on such non-member banks, occupied exactly the same position as any other holder of checks drawn on such bank. There was no obligation on the drawee bank to the Federal Reserve Bank or the holder of such check unless and until such check was presented for payment at the counter and it was the duty of the Federal Reserve Bank, under the law, to thus present the check promptly and demand payment, and in event of non-payment, to protest the same and

return the check to the original holder in order that he and the intervening endorsers might protect their rights therein. A strict conformity with the legal rights of the parties might, however, result in inconvenience and expense, both to the Federal Reserve Bank, as the holder of the check, and to the drawee bank, in making payment thereof. It was, therefore, competent for the Federal Reserve Bank to arrange with the drawee banks not members of the system that check received by the Federal Reserve Bank would be forwarded by mail for presentation and collection, and that in consideration of the drawee banks waiving the actual presentation at counter, which was their legal right, the Federal Reserve Bank would accept in settlement of the amount of said checks, the draft of such drawee banks upon their exchange of deposits, which draft should be satisfactory as to character and place of payment to the Federal Reserve Bank.

But under the amendment of June 21, 1917, this right to make a voluntary modification of the legal status was subject to the provision of the Act of Congress that no charge should be made against the Federal Reserve Bank for payment or remission of checks by exchange or otherwise. Since the Federal Reserve Bank was subject to the act of Congress, and its right to contract was dependent upon and limited by that act, then, if the non-member banks, as a condition of entering into the arrangement for payment or remission by mail, insisted upon the charge of exchange, the Federal Reserve Bank could not enter into the contract, and was forced to fall back upon its legal right and duty to present the check at the counter and demand payment.

This is what the defendant, Federal Reserve Bank of the Fifth District did. As to all non-member banks which would agree to remit by draft at par, the defendant arranged to send checks for collection through the mail in accordance with the usual custom of business,

and to accept in settlement therefor satisfactory drafts of such non-member banks upon their reserve deposits in other banks, but where the non-member bank refused to remit at par and stood on its legal right either to demand an exchange charge for remittance or to require the presentation of the check at counter for payment, which it had a perfect right to do, then the Federal Reserve Bank had no alternative in the exercise of its authority and discharge of the duty and obligation imposed upon it to collect such checks, but to conform to the law and to present the check at the counter of the non-member bank for payment. In doing this, it was only exercising the authority and discharging the duties and obligations imposed by the express provision of the act of Congress, subject to the limitations prescribed in that act, and was exercising this authority and discharging these duties strictly in accord with the legal rights of the parties and exactly as any other holder of the check would have been required to do under similar circumstances. Since it exercised this authority and discharged this duty promptly without saving up or accumulating checks and with due regard to the rights and convenience of the drawee banks, as found by the court below, it was guilty of no wrong and violated no rights of the drawee banks, and, therefore, could not be subject to injunction.

This was a construction of Section 13 of the Act accepted and applied by the Supreme Court of North Carolina, and its construction was clearly right and should be affirmed.

Having thus placed before the court the construction of this section of the act for which we contend, and which was sustained by the Supreme Court of North Carolina, and the respective rights, duties and obligations of the parties, resulting therefrom, we will now notice briefly the several contentions of counsel for the complainants as set forth in their brief in this court with respect to the construction thereof.

3. *The positions of the complainants with respect to the construction of Section 13 of the Federal Reserve Act.*

The arguments of counsel for the complainants (petitioners in this court) with respect to the construction of Section 13 of the Federal Reserve Act will be found under points one and two of their opening brief before this court, pages 8 to 21, inclusive. The several positions there taken as we understand them, will be considered in their order.

(a) *The contention that Congress could not by legislation or otherwise regulate the business or charges of non-member banks of North Carolina.*

It is unnecessary to consider the legal arguments of counsel on this subject, since it is our contention, which we think clear from a consideration of the law in connection with the facts and circumstances of this case, that Congress has not attempted to regulate or control the charges of non-member state banks. We submit that the arguments of counsel upon this point are predicated upon a misconception of the legal principles applicable to the transactions under review. It is admitted, of course, and expressly stated by counsel (Brief, p. 10), that Congress has full and complete power to legislate as to the Federal Reserve Bank and the Federal Reserve system. In the exercise of this power Congress has declared that the Federal Reserve Banks shall be authorized and under proper construction as we have shown, it shall be their duty and obligation, to receive and collect checks on all banks, member and non-member, within their respective districts, and has then expressly provided that no charge shall be made against the Federal Reserve Bank by such drawee banks for payment or remission of checks by exchange or otherwise. This legislation constitutes the authority of the

Federal Reserve Bank and imposes the limitations upon that authority. The Federal Reserve Bank must collect these checks. When a check upon a non-member bank, which it is required to receive and collect, comes into its possession, it has two alternatives:

(1) It may arrange by mutual agreement with the drawee bank to send that check for collection through the mails or other agency, and receive in discharge thereof satisfactory exchange or cash; or

(2) It may exercise its legal right to present the check at the counter of the drawee bank, through any agency it may select, and demand payment in cash, which is the contract represented by the check.

But it cannot in either case contract for or allow any charge against the Federal Reserve Bank for payment or remission of this check.

The first method would be obviously the more convenient. But since the drawee bank owes no obligation to the Federal Reserve Bank as the holder of this check until it is presented, the drawee bank may refuse to remit without deducting exchange. In that event the Federal Reserve Bank has no power to enter into an arrangement for remittance by mail or otherwise, since it cannot allow the charge for exchange. The parties being thus unable to agree as to a convenient method of handling the transaction and discharging the obligation, the Federal Reserve Bank has no alternative but to stand upon its legal rights and discharge its legal duty exactly as the drawee bank has elected to stand upon its legal right. This legal right and obligation of the Federal Reserve Bank is to present the check at the counter and demand payment in lawful money, and in event payment is refused to return check as dishonoured.

It is clear, therefore, that the Act of Congress au-

thorizing and requiring the Federal Reserve Bank to receive these checks for collection, and thus to collect the same, and prohibiting it from accepting any charge against it for payment or remission thereof by exchange or otherwise, does not in any way modify or affect the legal rights of the non-member drawee bank. It is simply a limitation upon the right of the Federal Reserve Bank to contract for the payment of the check by a method other than that prescribed by the technical law, unless in consideration therefor the drawee bank is willing to pay the same at par without charge for payment or remission. The drawee bank is under no obligation whatever to do this. It can stand on its legal rights. But it cannot force the Federal Reserve Bank to enter into a contract different from the legal rights of the parties to allow the drawee bank to deduct exchange when the making of that contract by the Federal Reserve Bank is expressly prohibited by Act of Congress. If, therefore, the drawee bank elects to stand on its legal right to have the check presented at counter unless the Federal Reserve Bank will consent to an arrangement which it is prohibited by law from making, the Federal Reserve Bank is forced in the discharge of the duty imposed upon it by Congress to collect the checks strictly in accordance with the law, and present the same at the counter of the bank for payment, just as any other holder of a check would do. It then becomes the obligation of the drawee bank to pay the same in lawful money at par, and if it refuses to do so, it is the legal duty of the Federal Reserve Bank as holder of the check to give notice that it has been dishonored by non-payment.

It would seem obvious, therefore, that the Act of Congress controlling the Federal Reserve Bank and limiting its power to contract for the allowance of exchange charges against it, is purely a regulation of the Federal Reserve Bank, which it is admitted Congress has the power to regulate. If the non-member state banks do

not wish to conform to this condition, they are entirely at liberty to stand on their legal rights and pay their checks at the counter in accordance with the contract between the parties represented by said check.

The whole argument of counsel on this point, therefore, proceeds upon the wrong theory as to the nature of the transaction under consideration, and when the nature of that transaction is made clear, the argument necessarily fails since there is no regulation or attempt to regulate non-member state banks.

(b) *The contention that the amendment of June 21, 1917, prohibiting charges for exchange against Federal Reserve Banks applies only to member banks and those non-member banks which avail themselves of the great privileges of the Federal Reserve system.*

We cannot conceive upon what theory counsel can ask the court to read into an Act of Congress absolute and general in its terms an exception not suggested in that act.

The Federal Reserve Bank is authorized and it is made its duty to receive and collect checks payable upon presentation *within its district* either upon member or non-member banks without exception, and whether such non-member banks elect to avail themselves of the collection facilities of the Federal Reserve system or not. This provision of the statute covers all checks payable upon presentation within the district. Then the language of the limitation is that "no such charges (that is, charges for collection or payment of checks by exchange or otherwise,) shall be made against the Federal Reserve Bank."

The language of the statute clearly authorizes the Federal Reserve Bank to accept and collect checks upon non-member banks which do not avail themselves of the collection facilities of the Federal Reserve system. As

to this there can be no question, for the statute is perfectly clear. It covers all checks payable upon presentation within the district, without reference to the drawee. Then it says that no charge for collection or payment or remission by exchange or otherwise shall be made against the Federal Reserve Bank.

How can there be read into this statute an exception in favor of those non-member banks who do not collect through the Federal Reserve Bank? If they do not wish to avail themselves of the collection facilities of the Federal Reserve Bank they need not do so. If they do not wish to remit by mail in payment of the checks by draft on their reserve deposits without deducting exchange, they do not have to do so. But in that event, since they stand upon their legal right to have the check presented at counter by the holder, they must pay the check when so presented at par in lawful money, and they cannot complain if the Federal Reserve Bank exercises its authority and discharges its duty under the Federal law to so present the check.

(c) *The contention that the Federal Reserve Bank only acts as agent in the collection of such checks and that an exchange charge against it would not be a charge against the bank but against the principal for which it acts.*

It seems to us entirely immaterial whether the Federal Reserve Bank, in presenting a check upon a non-member bank, is the actual owner thereof, or is merely the holder for the purpose of collection, and there is nothing in the Act of Congress which indicates any intent to distinguish between those checks which it holds as owner and those checks which it holds for collection. In fact, the determination of the relationship of a Federal Reserve Bank to checks deposited with it, is in the case of each check a mixed question of law and fact. If the depositor draws against the credit extended on

the check the bank becomes the holder, otherwise it is an agent for collection.

The whole argument of counsel on this branch of the case seems to proceed upon the erroneous theory that a drawee bank has the legal right to deduct exchange for the payment of its checks. This is not the case. The obligation of the drawee bank is to pay the check for the full amount in lawful money when presented at its counter. If, for convenience, the holder of the check desires to send it for collection through the mails or other agency direct to the drawee bank, and to ask the drawee bank to remit at par in payment thereof, then in consideration of this convenience to the holder, the drawee bank has a right to contract as to the terms upon which it will remit, and thus vary its legal obligation by contract with the holder. If it refuses to remit except upon the payment of a charge therefor in the nature of exchange, and the holder, whether it be the Federal Reserve Bank or any other person or institution, declines to pay this charge as a consideration for the convenience of having payment remitted instead of presenting the check at counter, it has a perfect right to refuse to accept the charge, or to enter into the arrangement for the modification of the legal rights of the parties. It then has the right to present the check at counter, which is its contract right, and demand payment of the drawee bank in cash.

Since the holder of checks drawn upon non-member banks have the right to refuse to pay exchange charges, they have the right in the absence of any limitation of powers of the Federal Reserve Bank by statute, to require the Federal Reserve Bank as their agent to refuse to pay such exchange charge, and to present the check at the counter as the original holder would have the right to do. In that event it becomes the duty of the drawee bank to pay at par in lawful money. It is therefore immaterial whether the Federal Reserve Bank pre-

sents the check as owner or as the agent of some other owner. The principles of law are the same.

But it should be noted that the language of this statute makes clear the intent of Congress on the subject. The statute does not say that the Federal Reserve Bank shall not pay exchange itself, but says that no charge for payment or remission of exchange shall *be made against the Federal Reserve Bank*, that is, the Federal Reserve Bank *is not authorized to accept such charge* on any check which it collects, or to contract for any such charge whether it presents the check as owner or as agent for collection. It is authorized to collect the checks whether as owner or agent, no distinction being made in the Act. It is prohibited from accepting any deduction for exchange. If it cannot arrange with the drawee nonmember bank to remit without deduction for exchange, then as holder of the check, whether as owner or agent, it must present the same for payment at the counter and receive lawful money therefor in order to comply with the Federal statute, which is the law controlling its action. This is no interference with the legal right of the drawee bank. It is merely a limitation upon the power of the Federal Reserve Bank to contract for a modification of the strictly legal method of collection of checks, or to accept any charge for exchange, whether it acts as principal or as agent.

It is contended by counsel that the collection of checks on state banks not members of the Federal Reserve System by the Federal Reserve Banks is not necessary. This argument might have been addressed to Congress as a ground for making exception in the statute, but it does not authorize the court to make exceptions which Congress did not make. The question of the necessity for putting into effect this universal system of par collection was a question to be determined by Congress in the exercise of its discretion to legislate in the public

interest. Congress having determined that it was necessary or desirable that the Federal Reserve Banks should exercise this authority and discharge this duty, and having fixed the conditions upon which they should do this, it only remains for the court to protect them in the discharge of the duties thus imposed. The question of the necessity or wisdom of this legislation has been determined by Congress and is not open for consideration.

(d) *The claim that the construction of the Act for which we contend is unjust to state banks, and will result in loss of revenue to them, and therefore should not be sustained.*

This also was a question for the consideration of Congress and not the courts. As we have already pointed out, the conditions under which the custom of charging exchange for the remission or payment of checks arose no longer exist. This charge imposed an enormous burden upon the commerce and industry of the country, an amount which we have already indicated at one-tenth of one per cent on the clearances through the Federal Reserve Banks for the year 1919 would aggregate $135,000,000 per annum. With the development of the system of par collection through voluntary clearing houses in the commercial and industrial centers of the country, and the imposition of exchange charges in the more sparsely settled and remote districts, when the necessity for remission of currency no longer existed, resulted in a severe discrimination against the industry of the outlying districts, which, in cases of competition, would be sufficient to be destructive of that industry. All of these and other considerations existed to appeal to the judgment of Congress for the establishment through the Federal Reserve system of a universal par clearance for the benefit of the whole country. The evolution of industrial and commercial life always results in apparent hardship to someone, but it is none the less necessary. The sub-

stitution of the railroad for the stage coach resulted in loss to those operating stage coach lines, and was earnestly resisted. This is an incident of every change in the industrial or commercial methods. It is none the less necessary to human progress that these changes should be made, that lost motion should be eliminated, that charges upon commerce, industry and exchange should be abolished when the conditions requiring them no longer exist. That there may be individual cases of losses resulting is true, but the general benefit, even to those who sustain immediate loss, from cheaper and better methods of doing business and resulting increase in industrial and commercial activities far more than offset the loss.

But all of these considerations should be addressed to the legislative branch of the government. In the case before us Congress, in the exercise of a power clearly vested in it, has, by legislation, developed through a series of amendments having a definite constructive purpose, authorized and required the Federal Reserve Banks to receive for collection and to collect checks payable upon presentation within their respective districts, regardless of whether they are drawn upon member or non-member banks or anyone else. This authority being given for the benefit of the banking system and the public at large, imposes a duty and obligation upon the Federal Reserve Banks to exercise the same. The Federal Reserve Bank is prohibited from accepting or permitting any charge for exchange in remission of checks. If the complainants or other non-member banks desire to have their checks sent for collection through the mails or other usual agencies, and to remit in payment thereof with acceptable drafts upon their reserve deposits, the defendant, Federal Reserve Bank, is ready, willing and anxious to make this arrangement to promote the convenience of the drawee banks and facilitate commercial exchange. But this arrangement can only be made by

consent of both parties and subject to the limitation imposed upon the Federal Reserve Bank by Act of Congress that it cannot accept any charge for exchange in the payment or remission of checks. If the non-member drawee banks are unwilling to remit by exchange without deducting such charge, then the Federal Reserve Bank is unable to accept the remittance, and is forced, in order to exercise the authority and discharge the duty imposed upon it by Act of Congress to present the check at the counter of the drawee bank and accept payment in cash, or in event of non-payment to return the same dishonored.

This is the course followed by the defendant in this case, and we submit that the Supreme Court of North Carolina was clearly right in sustaining its position, and in holding that under the terms of the Federal Reserve Act the Federal Reserve Bank of Richmond was prohibited "from permitting any discount to be deducted from the face amount of checks which it held for collection."

POINT II.

That the Act of the Legislature of North Carolina (Chapter 20, Public Laws 1921) upon which complainants rely is invalid in that it is in conflict with the valid Acts of Congress which, under the Constitution are the Supreme Law of the land, and in its purpose and effect it seeks to limit and restrain a Federal Agency created by Congress in discharge of the duties and functions imposed upon it by Acts of Congress.

The discussion of this point involves the consideration of the statute of North Carolina (Chapter 20, Public Laws 1921), in connection with the Federal Reserve Act, and especially Section 13 thereof, which has been reviewed and discussed. The North Carolina statute has already been quoted, and will be found in the Record at p. 79.

This subject will be examined in two aspects—(1) The contention that the North Carolina statute is in conflict with the provisions of the Federal Reserve Act, and (2) that it seeks to limit and restrain a Federal Agency created by Congress in the discharge of the duties and functions imposed by Congress.

(1) The act of the North Carolina Legislature (Chapter 20, Public Laws, 1921,) is invalid as to the defendant, as being in conflict with the provisions of the Federal Reserve Act, and especially Section 13 thereof.

The validity of this act is sought to be maintained upon the ground that it is a regulation by the legislature of North Carolina of state banks and trust companies organized under the laws of that state. We are not in this case concerned with the extent or the nature of the regulations imposed upon or prescribed for the benefit of state banks and trust companies of North Carolina by the legislature of that state, except as to the extent to which they may be in conflict with valid acts of Con-

gress for the regulation or control of the defendant, Federal Reserve Bank. To the extent to which such state statute may be in conflict with the Acts of Congress or in derogation of the power or rights of the defendant, Federal Reserve Bank, conferred by such acts, it is invalid as to the defendant and can give no basis for injunctive or other relief against the defendant. Whether its provisions which may not affect the defendant are invalid as regulations of state banks and trust companies, we need not inquire.

That such conflict exists is apparent from a most cursory examination of the provisions of the two acts. The act of Congress, as we have seen, imposes upon the Federal Reserve Bank created by that act the authority and duty to collect checks payable upon presentation, regardless of the banks upon which they are drawn, and provides that no charge shall be made against the Federal Reserve Bank for the payment or remission of said checks by exchange or otherwise.

The act of the legislature of North Carolina, Section 1, declares that it shall be lawful for all banks and trust companies of that state to charge a fee not in excess of one-eighth of one per cent on remittances covering checks, with a minimum fee of ten cents. Therefore, if the check held by the Federal Reserve Bank is paid by remittance, the Act seeks to authorize drawee bank to make a charge, which the Federal Reserve Bank is expressly forbidden by Act of Congress to accept.

In order to prevent the Federal Reserve Bank from avoiding this payment, and ~~still~~ collect the check by presentation at counter, Section 2 of the act provides that all checks drawn on state banks and trust companies of North Carolina, unless otherwise specified on the face thereof by the makers, shall be *payable* at the option of the drawee banks *in exchange drawn on the reserve deposits of such drawee bank*, when any such check is presented by or through any *Federal Reserve Bank*, post-

office or express company, or any respective agent thereof. Thus, it follows that while the Federal Reserve Bank cannot accept any charge for exchange for remission in payment of checks, yet the legislature of North Carolina undertakes to require that when the Federal Reserve Bank presents a check either direct or through the post-office or express company, it shall be payable by draft of the drawee bank drawn on its reserve deposits, and that by Section 1 of the act the drawee bank can make an exchange of one-eighth of one per cent. Thus, if this act be valid, the Federal Reserve Bank is forced to accept the charge of one-eighth of one per cent on all checks presented by it on state banks and trust companies of North Carolina, in the face of the positive provisions of the Act of Congress that no such charge shall be made. But the act goes further. In order to prevent the Federal Reserve Bank from avoiding these provisions, by presenting the checks at the counter and demanding payment at par, as every holder of a check is entitled to do under the law, Section 5 of the act expressly provides that no officer of the state shall protest a check for non-payment where payment is refused solely on account of the refusal of the holder or owner thereof *to pay exchange*, and no right of action will lie on such check. No one can read this statute without reaching the conclusion that it not only conflicts, but was intended to conflict with, and if possible, to override the provisions of the Federal Reserve Act.

Upon this state of the facts, the Supreme Court of North Carolina held that the state statute was invalid, as being in conflict with the Federal Reserve Act, and in reaching this conclusion said:

> "The Federal statute, being a regulation of the Federal Corporation by Congress, the Act of this State authorizing the paying bank *here to exact exchange is in direct conflict with the duty imposed* upon the Federal Reserve Bank by the Act of Con-

> gress and the Reserve Bank acts within its duty to observe the provision of the Federal Act by refusing to receive a check for less than the face amount of the check sent by it for collection. It is true it cannot enforce payment of the face amount except by personal presentation of the check at the counter of the paying bank but it has a right to refuse a check sent to it by the paying bank for less than the full face amount and to protest the check it has sent here for collection for non-payment. The matter then becomes one between the drawer of the check and the paying bank who refuses to pay it." (Italics ours.)

Assuming that the construction of Section 13 of the Federal Reserve Act for which we contend, and which was adopted by the Supreme Court of North Carolina, as conferring authority and imposing a duty upon the Federal Reserve Bank to collect these checks at par, is correct, then the construction of the state statute by the Supreme Court of North Carolina, holding that properly constructed it was in direct conflict with the Federal Reserve Act, is conclusive and binding in this court, and the subject is no longer open for discussion.

This rule is well settled in this court and has been applied in numerous cases in which the construction of a state statute by the highest court of the state is held to be binding upon this court, except in certain specified cases, otherwise provided by law, not here involved.

Providence Institution v. *Massachusetts*, 6 Wall. 611;

Great Western Telegraph Co. v. *Purdy*, 162 U. S. 329;

Gulf &c. Co. v. *Hewes*, 183 U. S. 66;

Lane County v. *Oregon*, 7 Wall. 71;

Noble v. *Mitchell*, 164 U. S. 397.

But assuming that this court may desire to examine

question further, we shall submit briefly the reasons
l authorities in support of our position, which need
be regarded if the court should accept the view that
construction of this statute, holding it to be in con-
with the Federal law, made by the Supreme Court of
rth Carolina is conclusive.

Article VI of the Constitution of the United States
vides as follows:

"This Constitution and the laws of the United States, which shall be made in pursuance thereof; and all treaties made, or which shall be made under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding."

In a consideration of this subject, it is recognized,
ourse, that in construing acts of Congress and acts
he State Legislature, the court will not hold the law
e invalid unless a clear conflict exists, or the legal
ct of the act of the Legislature is to restrain or limit
effect of an act of Congress. If, however, upon a
interpretation thereof it appears that there is any
flict between the two, the Act of the Legislature must
eld invalid as being in conflict with the supreme law
he land. As was stated by the Supreme Court of the
ted States in *McCray* v. *U. S.*, 195 U. S. 60:

"In such a case the result of a test of necessary operation or effect is to demonstrate for want of power because of the controlling nature of the limitations imposed by the Constitution of the United States."

In the case of *Hauenstein* v. *Lynham*, 100 U. S. 490,
court said:

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"It must always be borne in mind that the Constitution, laws and treaties of the United States are as much a part of the law of every state as its own local laws and Constitution. This is a fundamental principle in our system of complex national policy."

In discussing this question in the great case of *McCullough* v. *Md.*, 4 Wheat. 316, 426, Mr. Chief Justice Marshall lays down the principle as follows:

"This great principle is, that the Constitution and the laws made in pursuance thereof are supreme; that they control the Constitution and laws of the respective states, and cannot be controlled by them. From this, which may be almost termed an axiom, other propositions are deduced as corollaries, on the truth or error of which, and on their application to this case, the cause has been supposed to depend. These are, 1st, that a power to create implies a power to preserve. 2d, that a power to destroy, if wielded by a different hand, is hostile to, and incompatible with these powers to create and to preserve. 3d, that where this repugnancy exists, that authority which is supreme must control, not yield to that over which it is supreme."

The doctrine thus stated has so often been repeated and applied in cases involving State taxation, interstate commerce and other matters in which a conflict has arisen between the acts of Congress and State Legislature that it would serve no good purpose to accumulate authorities and decisions except to illustrate the doctrine and the limitations thereof well stated in the foregoing opinions. If the court desires to examine the general principle further, it is referred to the additional cases of

Northern Securities Co. v. *U. S.*, 193 U. S. 344;
Ex parte Sibold, 100 U. S. 398;
Cohen v. *Virginia*, 6 Wheat. 381;

Osborne v. *The Bank*, 9 Wheat. 738;
Waite v. *Dowley*, 94 U. S. 532;
Tenn. v. *Davis*, 100 U. S. 263;
Charge to the Grand Jury, 1 Sprague 602, 30 Fed. Cas. No. 18273.

In this celebrated Charge to the Grand Jury, the court lays down the principle as follows:

> "The Constitution and laws of the United States extend to, and are paramount over, all the territory of every state, and cannot be annulled nor the force of either of them be in any degree impaired by any law of a state, no matter in what form or with what solemnity such law may have been enacted, or by what name it may be designated; whether it be a constitution, an ordinance, a statute, or a resolve. So far as it conflicts with the Constitution, or with any valid law of the United States, it is utterly nugatory, and can afford no legal protection whatever to those who act under it."

The power of Congress to create national banks, such as defendant, The Federal Reserve Bank, has been thoroughly recognized and established since the cases of *McCullough* v. *Maryland*, 4 Wheat. 316, and *Osborne* v. *Bank*, 9 Wheat. 738, and this power has been exercised by Congress in the creation of the First and Second Bank of the United States, the National Banks of issue, and The Federal Reserve Banks.

It is equally well settled that this power to create banks carries with it the right on the part of Congress to confer on such banks all incidental powers which in the judgment of Congress may be reasonably necessary for the efficient and successful operation of the agencies so created, and the carrying out of the policy of Congress with respect thereto, in so far as the power is not limited by the express terms of the Constitution. Thus in the opinion of Mr. Chief Justice Marshall in *McCul-*

lough v. *Maryland*, 4 Wheat. 316, 421, so often quoted, it is said:

> "Let the end be legitimate—let it be within the scope of the Constitution—and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the Constitution, are constitutional."

See also

Osborne v. *Bank*, 9 Wheat. 738;
Legal Tender Cases, 12 Wall. 457;
Legal Tender Cases, 110 U. S. 421;
Davis v. *Elmira Savings Bank*, 161 U. S. 275;
First Nat. Bank v. *Michigan*, 244 U. S. 416.

It is not essential that the powers so conferred by Congress shall be necessary to the exercise of the original or primary purpose for which the bank or national agency may have been created, but if they are appropriate to the purposes for which such agency was established, or incidental to its operations and are not forbidden by the express terms of the Constitution, then the judgment of Congress as to whether they should be conferred upon such agency is conclusive, and its action in conferring such powers is binding upon the states and all governmental agencies thereof.

An allustration of this principle will be found in the case of *Davis* v. *Elmira Savings Bank*, 161 U. S. 275. In that case the State of New York by statute undertook to regulate the payment of the obligations of an insolvent bank. The court held this statute to be void as in conflict with Acts of Congress giving to the Comptroller of the Currency the power over the administration of insolvent national banks and providing for the distribution of their assets. At the very outset of his opinion in this case, Mr. Chief Justice Waite said:

"National banks are instrumentalities of the Federal Government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt, by a state, to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the Federal Government to discharge the duties, for the performance of which they were created. These principles are axiomatic, and are sanctioned by the repeated adjudications of this court."

One of the latest cases in which this doctrine has been applied is the case of *First National Bank* v. *Fellows*, 244 U. S. 416. In that case the court was called upon to consider the legislation of Congress conferring upon national banks the right to act as trustee, executor, administrator or registrar of stocks and bonds under such rules as The Federal Reserve Board might prescribe. Obviously the power to act as executor or trustee within a state is not one of the powers which can be primarily conferred by Congress, but Congress undertook by this statute to confer this power upon national banks as an appropriate power incident to their operation as banks, and in its judgment necessary for their successful operation in competition with other banking institutions. The Supreme Court sustained the act and the power of Congress to confer this right upon national banks. The effect of the decision is summarized in the following extract from the syllabus, pp. 416, 417:

"By the principles fully settled in *McCullough* v. *Maryland* and *Osborne* v. *Bank*, and other cases, the implied power of Congress to confer a particular function upon a national bank is to be tested, not by the nature of the function viewed by itself, but by its relations to all the functions and attributes

of the bank considered as an entity; the necessity or appropriateness of the function should be considered with reference to the situation to which it relates; and, as to what is necessary or appropriate, a court should not substitute its judgment for the judgment of Congress.

"As settled also by those cases, the circumstance that a function is of a class subject to state regulation does not prevent Congress from authorizing a national bank to exercise it; nor would it lie with the state power to forbid this.

"A business not inherently such that Congress may empower national banks to engage in it may, nevertheless, become appropriate to their functions if, by state law, state banking corporations, trust companies, or other rivals of national banks are permitted to carry it on."

See also *Fidelity National Bank* v. *Enright*, decided by the United States Court for the Western District of Missouri in May, 1920, 264 Fed. 236.

In the application of these principles, the courts have been ever zealous to protect national banks from any effort of the states to discriminate against them by legislation or otherwise. This policy is well stated by the court in the case of *Tiffany* v. *National Bank of Missouri*, 18 Wall. 409, where it is said:

"National banks have been national favorites. They were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market fo the loans of the General Government. It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the states, or to ruinous competition with state banks."

See also

First National Bank v. *Commonwealth of Ky.*, 143 Ky. 816, 34 L. R. A. (N. S.) 54;

Hawley v. *Hard*, 72 Vt. 122, 52 L. R. A. 195;
State v. *Clement National Bank*, 84 St. 167, 78 Atl. Rep. 944;
Merchants' Natl. Bank v. *City of Richmond*, decided by Supreme Court in June, 1921.

In the light of recognized principles as illustrated in the authorities cited, it would seem to be too clear for argument that the conflict between the Federal and State statutes under consideration, which the Supreme Court of the State of North Carolina found to exist and to be fatal to the state statute, so far as the defendant is concerned, is too clear for serious controversy.

In one aspect this act seeks to make it impossible for the Federal Reserve Bank to collect checks on state banks and trust companies of North Carolina, which it is authorized and required to do by Act of Congress. Section 2 of the Act provides that any check drawn on state banks or trust companies of North Carolina, unless it is specified on its face to the contrary, shall be payable "in exchange drawn on reserve deposits of said drawee bank", when presented through the Federal Reserve Bank or the agencies named. If the act is valid the Federal Reserve Bank on presenting check, is compelled to accept this exchange draft. One drawee bank in North Carolina could, therefore, give an exchange draft on its reserve deposits in another bank in North Carolina, and that bank in turn could give an exchange draft on still another bank in North Carolina, and this might go on *ad infinitum*, so that the Federal Reserve Bank could never collect the check. Some of these drafts drawn on reserve deposits might prove to be worthless, and thus, the Federal Reserve Bank would lose the amount of the check. In this way it is sought to defeat entirely the right of the Federal Reserve Bank to collect checks on state banks and trust companies of North Carolina, although it is authorized and required to do so by act of Congress.

Further analysis of the act would seem to be useless. It is clear that its provisions are and were intended to be in direct conflict with the provisions of the Federal Reserve Act, and that the Supreme Court of North Carolina was clearly right in so holding. The Federal statute being made supreme by the provisions of Article VI of the Federal Constitution, it necessarily follows that the act of the legislature, insofar as it affects the defendant, is clearly invalid, and can constitute no basis for injunctive or other relief against the defendant.

(2) *The act of the legislature of North Carolina is invalid in that it seeks to limit and restrain a Federal Agency created by Congress in the discharge of the duties and functions imposed upon it by Act of Congress.*

As we have already pointed out, the Federal Reserve Bank exercises functions of two classes: (1) It is a fiscal or public agency of the United States, and (2) it exercises certain general functions of commercial banking corporations, such as the collection of checks, purchase and discount of commercial paper, making of loans and other similar transactions. The authorities already cited clearly establish the proposition that where Congress has power to create an agency of this character, it may confer upon such agency functions necessary to its successful operation, although they were not originally within the scope of congressional action, and the necessity or appropriateness of its act in conferring such functions upon such agencies is not subject to review by the courts.

As was said by this court in *First National Bank* v. *Fellows*, 244 U. S. 416:

> "As settled also by those cases, the circumstance that a function is of a class subject to state regulation does not prevent Congress from author-

izing a national bank to exercise it; nor would it lie with the state power to forbid this."

McCullough v. *Maryland*, 4 Wheat. 416, 421;
Fidelity National Bank v. *Enright*, 264 Fed. 236;
Tiffany v. *National Bank of Me.*, 18 Wall. 409;
Railroad Commission v. *Chicago &c. Railroad*, 66 Law Edition Supreme Court Reports 227;
Lemke v. *Farmers Grain Co.*, 66 Law Ed., Supreme Court Reports 273.

Congress having created this essential public agency, known as the Federal Reserve Bank, clearly has the power, in order, in its discretion, to provide for the successful operation of those banks and their maximum service to the public, to confer upon the banks the powers and duties of ordinary commercial banking corporations, including, among others, the power and duty to collect checks, and to act as a clearing agency for the collection thereof. This Congress has elected to do, and the wisdom or propriety of its action is not subject to review by the courts.

The legislature of North Carolina, in effect, undertakes to impose limitations and restraints upon the exercise of these functions and the discharge of these duties by the Federal Reserve Bank, and indeed undertakes to make the collection by the Federal Reserve Bank of checks drawn on state banks and trust companies of North Carolina impossible. This is clearly a limitation and restraint upon the exercise of the legitimate functions conferred by Congress upon an essential Federal Agency, and, therefore, invalid.

The principle as stated by this court in the recent case of *Lemke* v. *Farmers' Grain Co.*, 66 L. Ed., Supreme Court Reports 273, is applicable to this point:

"It is alleged that such legislation is in interest of the grain growers, and essential to protect them from fraudulent purchases, and to secure pay-

ment to them of fair prices for the grain actually sold. This may be true, but Congress is amply authorized to pass measures to protect interstate commerce if legislation of that character is needed. *The supposed inconveniences and wrongs are not to be redressed by sustaining the constitutionality of laws which clearly encroach upon the field of interstate commerce, placed by the Constitution under Federal control.*" (Italics ours.)

We submit, therefore, that the act of the legislature of North Carolina, insofar as it affects the defendant, or is relied upon as the basis for injunctive or other relief against the defendant, is invalid for both reasons stated, and that the Supreme Court of North Carolina was clearly right in so holding.

(3) *The position of counsel for complainants (petitioners here) examined.*

This subject is discussed by counsel for complainants under Point 3 of their opening brief in this case, pp. 22-28. In this discussion counsel undertake to set forth and maintain the validity of the several sections of the act separately. We take it to be an elementary principle of construction that the provisions of a statute must be taken as a whole, and the intent of the legislature and the effect of its action arrived at from the consideration of the instrument as a whole. Thus viewed, there can be no question but that this state statute was passed for the purpose of preventing the Federal Reserve Bank from doing what it was authorized and empowered to do by Act of Congress, and the holding of the Supreme Court of the State of North Carolina to that effect is conclusive.

Counsel discuss this question under two headings, each of which will be noticed.

(a) *The contention that Section 1 of the act is not*

repugnant to the Hardwick Amendment, being a mere regulation of exchange charges by State banks.

It is suggested by counsel that we rely upon the provisions of the Amendment June 21, 1917, to Section 13 of the Federal Reserve Act, and that this was not intended to restrict exchange charges by state banks. We have already considered this subject and will not weary the court by repetition of the argument. We do not rely exclusively upon the Amendment of June 21, 1917, but upon the provisions of the Federal Reserve Act, and especially Section 13 thereof, as a whole. These provisions even before that Amendment was enacted clearly authorize the Federal Reserve Bank to receive and collect checks on non-member banks as well as member banks.

Prior to the Amendment of June 21, 1917, the Federal Reserve Bank might have allowed exchange charges to non-member banks for remission in payment of checks, but if it did not desire to do so, it had the right, as any other holder of a check, to present it at counter and demand payment at par in lawful money. When this Amendment was passed, the Federal Reserve Bank no longer had any option in the matter, as it was thereby expressly prohibited from paying charges for exchange on the collection of any checks without exception or discrimination. It was compelled, therefore, in order to discharge the duty of collecting checks, as required by the terms of the Federal Reserve Act, to either induce the drawee bank to remit by satisfactory draft at par, or if the drawee bank refused to do this, to present the check for payment at the counter of the bank and demand lawful money therefor without deduction for exchange.

As we have already pointed out, the authority to collect checks being given for the benefit of member banks and the public was mandatory, and since the

drawee state banks refused to remit at par, the Federal Reserve Bank was compelled to present the checks promptly and demand payment at par in lawful money.

The act of the legislature of North Carolina undertook to prevent this in the manner already set forth, and it was, therefore, clearly invalid as being in conflict with the Federal Statute.

(b) *The contention that Section 2 of the Act does not conflict with the Act of Congress.*

Section 2 of the act must be construed together with Section 1, which allows state banks and trust companies of North Carolina to charge an exchange on remittances in payment of checks. Section 2 then requires the Federal Reserve Bank to accept exchange drafts in payment of checks, which, under Section 1, gives to the bank issuing the draft the right to deduct exchange. The two sections thus taken together seek to confer upon the banks and trust companies of North Carolina the right to pay their checks by exchange drafts on reserve deposits, and to deduct one-eighth of one per cent. exchange for making such payment, and to require the Federal Reserve Bank to accept such payment if it collects the check, while the Federal statute prohibits the Federal Reserve Bank from accepting any such charge.

But this section goes even further and undertakes to force the Federal Reserve Bank, if it collects checks on state banks and trust companies of North Carolina, to accept exchange drafts on their reserve deposits, whether the drafts be good or bad, and make checks drawn on such banks *payable* by such exchange drafts. We will consider this phase of the matter when we come to discuss the constitutionality of this act, on the ground that it undertakes to make something else than gold and silver coin legal tender in payment of debts.

Counsel contend that the purpose of this statute was to protect the banks from financial violence or warfare on the part of the Federal Reserve Bank. We recognize, of course, that a lawful act may be done in an unlawful manner, but this question is entirely eliminated from this case by the finding of the court below, affirmed by the Supreme Court of the State of North Carolina, that the defendant was guilty of no wrongful conduct or method of presenting these checks, but presented the same promptly without intent to wrong or inconvenience the drawee banks. To this finding there was no exception.

It is not competent for state legislature to prohibit a Federal Agency from discharging in a lawful manner those functions and duties imposed upon it by Act of Congress, because some other institution may, in the discharge of such duties, commit unlawful acts. If unlawful acts are committed or threatened, the court should prevent such acts, but the legislature cannot on that ground forbid the doing of lawful acts authorized by act of Congress by such agencies. There is no question of financial violence or warfare in this case. The record presents a simple question of law and the Supreme Court of North Carolina correctly held that the act was invalid, for the reason that it was in conflict with the essential provisions of the Federal Statute.

It is suggested that if the position for which we contend is maintained, Congress may by chartering corporations and conferring limited powers coerce corporations of states to forego their rightful revenues and deprive the states of the power to protect such corporation from such practices. We are not concerned with what Congress may or may not do. The subject is too broad for general discussion. If a wrong arises by virtue of an Act of Congress, or otherwise, the remedy will be found for that wrong in the proper forum. We prefer to confine ourselves to a discussion of this case, and rely

upon the principle stated by this court in *Lemke* v. *Farmers' Grain Co., supra,* that:

> "The supposed inconveniences and wrongs are not to be redressed by sustaining the constitutionality of laws which clearly encroach upon the field of interstate commerce, placed by the Constitution under Federal control."

So we submit that "the supposed inconveniences and wrongs" suggested, if such arise in the future, may be remedied in the proper forum, but they are not to be redressed by sustaining the constitutionality of state statutes which clearly encroach upon the field of and are in conflict with valid Federal statutes, and seek to limit and restrain an essential Federal Agency in the discharge of those functions and the performance of those duties which Congress, in its discretion, has imposed upon it. We submit, therefore, that the holding of the Supreme Court of North Carolina on this point was clearly right and should be affirmed.

POINT III.

That the Act of the Legislature of North Carolina (Chapter 20, Public Laws 1921) upon which complainants rely is invalid, in that it violates the provisions of Article I, Section 10, of the Constitution of the United States, which prohibits any state from making anything but gold and silver coin a legal tender in payment of debts.

Our position on this point is that the Act of Congress authorizes and imposes the duty upon the Federal Reserve Bank to receive for collection, and thus to collect, checks and drafts payable upon presentation in its district, which necessarily includes checks and drafts drawn upon state banks and trust companies in North Carolina. Such checks and drafts are by their terms payable in dollars, which obviously means lawful money of the United States. The Legislature of North Carolina, by Section 2 of the Act of February 5, 1921, undertakes to declare that when any such check is presented by or through the Federal Reserve Bank, post-office or express company, or any agent thereof, such check shall unless specified on the face thereof to the contrary by the maker be "*payable at the option of the drawee bank in exchange* drawn on the reserve deposits of said drawee bank." (Italics ours.) The Act of Congress also prohibits any charge against the Federal Reserve Bank for the payment of checks and remission therefor by exchange or otherwise, and thus prohibits the Federal Reserve Bank from accepting or allowing any such charge. Section 1 of the Act of the Legislature of North Carolina seeks to authorize state banks and trust companies in that state to deduct one-eighth of one per cent as an exchange charge for remittances covering checks; and Section 5 of the Act prohibits any protest for nonpayment of any check drawn on any bank or trust company chartered by that State, when payment is refused

by the drawee bank, solely on account of the failure or refusal of the owner or holder thereof to pay exchange authorized by the Act, and provides that no right of action shall lie on such check on account of such refusal to pay the same. The effect of these provisions of the state statute, if valid, is to authorize state banks to tender, and to force the Federal Reserve Bank to accept *in payment* of any check which it may receive for collection on the state banks and trust companies of North Carolina exchange drafts drawn on reserve deposits of the drawee bank, instead of lawful money of the United States. It is our position that this legislation constitutes a clear effort on the part of the state to make checks which by their terms are payable in lawful money payable in something else than lawful money, and thus to make something other than gold and silver coin a tender in the payment of debts. Obviously if the debt can be paid or discharged with an exchange check, the tender of an exchange check is a valid tender for the payment thereof.

The conflict between the provision of the Constitution of the United States and the statute in question would seem to be clear from an examination of the pertinent provisions of the two instruments.

Article I, Section 10 of the Constitution of the United States provides:

> "No state shall * * * make anything but gold or silver coin a tender in payment of debts."

Section 2 of the Act of the Legislature of North Carolina provides that unless otherwise specified on the face thereof a check, which is an order for the payment of lawful money of the United States, shall

> "be payable at the option of the drawee bank in exchange drawn on the reserve deposits of said drawee banks."

The provisions are directly in conflict both in language and intent.

The bill of complaint in this case (Rec., p. 6) avers the right of the complainant banks to pay checks drawn on them and presented through the Federal Reserve Bank, with exchange drafts instead of lawful money, and the prayer of the complainant is that the Federal Reserve Bank be permanently restrained and enjoined

> "from carrying out its threat to refuse to accept exchange drawn by the plaintiffs on their reserve deposits *in payment of checks presented*, and to return such checks to the drawers thereof dishonoured because the plaintiffs *have refused to pay same in cash* and have *tendered* the exchange allowed by the laws of the State of North Carolina." (Italics ours.)

It thus appears that the complainants have asserted the right to pay their checks, or tender in payment thereof exchange drafts in lieu of lawful money, and they are of course bound by this construction of the Act.

Our position on this point was sustained by the Supreme Court of North Carolina in the following brief statements in its opinion:

> "No act of this state can authorize the drawee bank to pay less than the face amount of the check drawn upon it by its depositor or to remit its check in payment or pay it other than in legal tender money.
>
> "It is true that the Federal Reserve Bank as holder of the check has no contract rights with the drawee bank until the check is presented, but as holder it can require payment of the face amount on the check in legal tender.
>
> "It is true it can not enforce payment of the face amount except by personal presentation of the check at the counter of the paying bank, but it has a right to refuse a check sent to it by the paying bank for less than the full face amount and to protest the check it has sent here for collection for non-payment."

A person having on deposit in a state bank or trust company in the State of North Carolina adequate funds in lawful money of the United States, issues a check payable in dollars upon presentation to the bank. The check is presented at the counter of the bank in due course of business through The Federal Reserve Bank of Richmond, Virginia, or the post office, or an express company. Under decisions of the Supreme Court a check payable in dollars may only be paid in lawful money of the United States. The Legislature of North Carolina undertakes to say that the bank can pay and discharge this check by giving therefor its exchange draft on deposits in another bank. It is difficult to see how it can be contended that this is anything but an effort on the part of the State of North Carolina to make something else than gold or silver—namely, a bank draft —"a tender in payment of debts" in direct violation of the provisions of the Constitution of the United States, and the bill of complaint asserts the right to "tender" such exchange in payment as the basis for the relief sought.

The history of this provision of the Constitution, which is a matter of common knowledge among all who are familiar with the early history of this country, emphasizes this conclusion, and the language of the provision itself is so clear that it is not open to discussion.

As we have already pointed out during the period of the Revolution and the years which followed prior to the adoption of the Constitution of the United States, the various states of the Union issued paper money in large amounts, and by legislation made the same legal tender in the payment of debts. This legislation, in the language of Mr. Justice Story, "prostrated all public credit and private morals." It was to avoid the continuance of this practice and to protect the credit and good faith of the several states and of the people thereof that the provisions of the Constitution prohibiting the

states from emitting bills of credit, passing any acts to impair the obligation of contracts or making anything but gold and silver legal tender in the payment of debts were adopted. For a full discussion of this subject and of the origin and intent of these provisions of the Constitution see the following authorities:

44 Federalist.
Hepburn v. *Griswold*, 8 Wall. 603.
Legal Tender Cases, 12 Wall. 457.
Legal Tender Cases, 110 U. S. 421.

See especially the dissenting opinion of Mr. Justice Field in the latter case, where the history of these provisions of the Constitution is fully revieved.

The language of this provision of the Constitution is so clear and its purpose was so well understood, that there are very few decisions of the courts bearing upon the same.

In only two cases can we find that the Supreme Court of the United States has been called upon to apply directly provisions of the Constitution.

In *Quinn* v. *Breedlov*, 2 How. 38, a marshal in the State of Mississippi accepted State Bank notes in discharge of an execution levied upon the property of the debtor. The creditor insisted upon payment in lawful money of the United States. In disposing of this claim the Supreme Court, after determining that by the Constitution of the United States gold or silver coin only could be tendered in the payment of debts, held that the marshal having received bank notes in satisfaction of the execution and having made his return thereon could only

> "pay into court gold or silver, if required by the execution creditor to do so, and, therefore he ran the risk of converting the notes into specie when he took them; and having incurred the risk the marshal must bear the loss by depreciation."

Again in the case of *Griffin* v. *Thompson*, 2 How. 244, the court held that a marshal had no right to receive in satisfaction of a judgment bank notes in general circulation, and that if he did receive such papers, and the plaintiff refused to accept the same, the court would not order the execution satisfied.

The case of *Lowry* v. *McGehee &c.*, 16 Tenn. 242, is one of the few decisions by state courts in which this provision of the Constitution has been discussed. In that case the statute authorized the redemption of lands within two years by the repayment of money which the purchaser had paid at the sale under execution. An Act of 1819 authorizing the payment of bank notes in discharge of execution was held to be unconstitutional, and the Supreme Court of Tennessee held that under the Act of 1820 authorizing the redemption of lands payment could only be made in gold and silver coin which alone could be legal tender under the constitution of the United States. Although the two statutes undertook to authorize the person redeeming to pay in bank notes the court held that the Legislature in Tennessee had no authority to do so, and that the redemption could only be made in legal tender money.

See also

Gaines v. *Reeves*, 8 Ark. 221.
State v. *Beackmo*, 8 Black (Ind.) 250.

It is submitted that in the light of the principles and authorities above set forth, and the express language of Section 10 of the Constitution of the United States, the Act of the Legislature of North Carolina which seeks to authorize the state banks and trust companies of that state to tender in payment of and to pay checks presented through the defendant, the Federal Reserve Bank, or any post office or express company in exchange of such drawee banks, although the check by its terms is

payable in dollars, is a clear violation of the Constitution of the United States, and is therefore wholly invalid, and that the Supreme Court of North Carolina was right in so holding.

2. *The positions of counsel for complainants, petitioners here, on this point considered.*

Counsel for petitioners (p. 29 *et seq.* of their opening brief) undertake to avoid the effect of this obvious conflict between the provisions of the Act of the State Legislature in North Carolina, and Article I, section 10 of the Federal Constitution, and the decision of the Supreme Court of North Carolina holding that such conflict exists, upon several grounds, which will be considered in their order.

(a) *The contention that the state can authorize the drawee bank to pay less than the face amount of the check drawn upon it by its depositor.*

This contention is not admitted. It presents a broad question of general law, a consideration of which we deem unnecessary in this case.

Assuming that the State Legislature can authorize a state bank to pay less than the face value of a check drawn upon it by a depositor payable in dollars for a fixed amount, and held by a third party, it cannot force this third party to accept less than the face amount of the check. The holder could refuse to accept a less amount, and while he might have no right of action against the bank, he would have a right of action against the drawer of the check and all intervening endorsers for the full amount for which the check was drawn. In order to perfect this right against the drawer and prior intervening endorsers, it would be necessary for the holder to present the check and upon refusal of the drawee bank to pay the full face amount thereof, to return the same as dishonoured, and assert his right

against the drawer and prior endorsers. This is what the defendant did in this case.

But regardless of the question of the power of the state to authorize the payment by the banks of a check for less than the amount thereof, which, as stated, we do not concede, there is certainly no power in the state to require the Federal Reserve Bank authorized by Congress to collect checks on banks in that state and prohibited by Act of Congress from allowing charges for exchange, to accept in payment of the check anything but lawful money, or to accept in lawful money a less amount than the face amount of the check or any deduction for exchange. If this could be done, a state statute could override a valid Act of Congress.

> (b) *The contention that the state can provide, unless the depositor designates in the face of the check to the contrary, such check shall be payable between banks in the universal banking media, that is, a draft on the reserve deposits of the payee bank.*

This contention is clearly unsound. This will appear from an analysis of the legal relationships of the parties, which is a matter of elementary law.

A depositor in a state bank of North Carolina issues his check for $1,000 payable to bearer, or to the order of some third person. This check may or may not pass into the hands of several endorsers. It comes into the hands of the Federal Reserve Bank or any other bank in due course for collection. The holder of the check has no contract relationship with and no right of action against the drawee bank. This of course is admitted. But the holder has a contract with the drawer and all prior intervening endorsers, to the effect that if the check be promply presented to the drawee bank and not paid such drawer and prior endorsers will make good the amount thereof. As a condition precedent to asserting this contract right, however, the holder must present the check

to the drawee bank. The drawee bank then has the option to accept the same or to refuse payment. If it accept the check it becomes obligated to the holder to pay the same in lawful money of the United States for the full amount thereof. If it refuses to pay the same or tenders in payment thereof anything but gold or silver coin or legal tender money, the drawer may refuse to accept such tender, since it is not legal tender, treat the illegal tender as refusal to pay, and notify prior endorsers and the drawer and demand reimbursement for the face amount thereof. If a legal tender be made, that is, gold or silver coin or legal tender money, it releases the drawer and prior endorsers from further obligation to the holder, and the holder must look to the bank.

It follows from a mere statement of these principles of law, which are elementary, that in order to discharge the drawer and prior endorsers from obligation to the holder there must be a legal tender by the bank within the meaning of the Constitution of the United States, and if such tender is not made the drawer and endorsers are not discharged and the check is dishonored, and the holder must protest for non-payment and give notice of dishonor in order to assert his right against prior endorsers or the drawer thereof.

The Constitution of the United States provides that no state can make anything but gold or silver coin legal tender in the payment of debts. It therefore follows that whatever may be the custom of the banks and the media of payment commonly used by them in discharging their balances, this custom cannot override the Constitution of the United States, nor can the state do so by Legislative Act. The holder of the check may at his own volition accept something other than legal tender in payment, but he cannot be made to do so as a matter of law by state statute or otherwise. His legal right is to present the check to the bank, demand payment in legal

tender money of the United States, and if payment in legal tender money be refused, to return the check and assert his rights against the drawer or prior endorsers. The state cannot by statute or otherwise change his legal right to demand legal tender money as defined by the Constitution and laws of the United States.

(c) *The contention of counsel that the debt of the bank is to the depositor and the Act of the Legislature does not seek to authorize the bank to discharge its obligation to the depositor in an exchange draft.*

The question of the rights of the depositor are not involved in this litigation. The Federal Reserve Bank is authorized by Act of Congress to receive and collect checks in due course drawn upon the state banks of North Carolina. When it does receive these checks for collection or otherwise it acquires certain legal rights and assumes certain contractual obligations with respect thereto. It is true, as we have stated, that as the holder of such check it has no contract right as against the drawee bank; but it does have a contract right against the drawer and intervening endorsers for the payment of the full amount of the check. In order to enforce this contract right it must present the check to the drawee bank for payment in accordance with its terms. If a legal tender be made by the drawee bank, the rights of the holder against the drawer and prior endorsers is lost. But the contract right of the holder against the drawer and prior endorsers cannot be lost or affected by the tender of an exchange draft, or anything else but legal tender money, nor can the holder be required under the Constitution of the United States to accept anything but legal tender money. It is not a question of right of the depositor, but a question of the right of the Federal Reserve Bank as a holder in due course of a check in process of collection.

(d) *The contention that the Act of the Legislature of North Carolina, being prospective in its operations, enters into and forms a part of the contract represented by every check drawn upon a state bank of North Carolina, and that every person or institution which accepts that check consents to the implied contract.*

The answer to this position is two-fold. In the first place we are not discussing the question of impairment of obligation of contract, which is not involved in this case. We are dealing with the question of legal tender The provisions of the Constitution of the United States with respect to legal tender apply as much to prospective contracts as to past contracts. The state can no more authorize a tender in payment of a future debt in anything which is not legal tender under the Constitution and laws of the United States than it can authorize such tender in payment of a past debt. The legal tender provision of the Constitution is universal, and applies to all obligations past and present. The bill of complaint in this case prays that the defendant may be permanently enjoined from refusing to accept exchange drafts drawn by complainants on their reserve deposits in payment of checks presented, and from returning checks to the drawers thereof dishonoured because the complainants have refused to pay the same in cash and have *tendered* the exchange allowed by the laws of the State of North Carolina. Our position is that the tender of anything but legal tender money in payment of the check is not a legal tender, and therefore is in legal effect a refusal to pay, which makes it necessary for the Federal Reserve Bank as holder in order to protect his contract rights against the drawer and prior endorsers, to return the same as dishonoured. It necessarily follows that the injunction prayed cannot be granted without holding that to be a legal tender which is not a legal tender under the Constitution of the United States, and therefore must be denied.

In the second place, it is submitted on this point that the provisions of this Act being entirely inconsistent with and in direct conflict with the express provisions of the contract embodied in the check cannot by fiction of law be construed to enter into the contract or operate as a rule for the construction thereof.

In support of their position on this point, counsel relied in the court below upon the cases of *Farmers Bank of Nashville* v. *Johnson King and Co.*, 134 Ga. 486, and *Commercial National Bank* v. *First National Bank*, 118 N. C. 783, and in their brief in this court they cite the latter case and seem to rely upon a line of cases to the same effect.

In each of the cases above referred to there was written across the face of the check a provision requiring its presentation through a certain bank, or prohibiting its presentation through certain other banks. The court sustained this limitation upon the agency through which the check could be presented when expressed on the face of the check, basing their decisions largely upon the authority of the English cases with respect to "Crossed Checks" or checks across the face of which was written the name of the bank through which the same should be presented for payment.

We admit that it is entirely legal for any person drawing a check upon his own bank deposit, in terms upon the face of the check to direct the bank through which the same shall be presented, and that where such express direction is contained on the face of the check, although it may affect its negotiability no action will lie against the drawee bank for refusal to pay the same unless presented in accordance with such direction.

But the individual making a contract or drawing a check may write provisions into that contract which the Legislature of a state cannot by implication place therein, especially where such implied meaning is in direct opposition to the language used by the contracting

parties. For instance, it would not be competent for the Legislature of a state to say by statute that any person entering into a contract to deliver 100 bushels of wheat meant thereby that he would deliver 100 bushels of oats, or could discharge his contract by the delivery of 100 bushels of wheat by making delivery of 100 bushels of oats. Such an act would be in effect a legislative declaration that the language used must be construed to mean something entirely different from its meaning in common use, and its general acceptation. The Legislature cannot under its admitted power to enact reasonable rules for the construction of contracts create presumptions which produce such conflicting results, and in effect deny to the individual the right of contract in the English language.

A written instrument embodying the terms of an agreement between parties called a contract is merely evidence of the existing contract achieved through the meeting of the minds of the parties thereto. The state can undoubtedly establish reasonable rules for the interpretation of such instruments, and provide that certain language or certain acts raise a presumption of a certain intent, but the presumption must always be one which *will naturally flow from the language used or the acts done, and not one which is in conflict with or directly opposed to the natural and probable intent of the parties derived from such language or acts.*

Thus in *McFarland* v. *American Sugar Refining Co.*, 241 U. S. 79, the Legislature of Louisiana by statute undertook to declare that where a person paid a less price for sugar in Louisiana than he paid in any other state, such act should create a presumption that such purchaser was a party to a monopoly or conspiracy in restraint of trade. The Supreme Court of the United States in holding this act unconstitutional, said, at page 86:

"As to the presumptions, of course the Legislature may go a good way in raising one or in changing the burden of proof, but there are limits. It is essential that there shall be some rational connection between the fact proved and the other fact presumed, and that the inference of one fact from proof of another shall not be so unreasonable as to be a purely arbitrary mandate."

Citing *Mobile &c. R. Co.* v. *Turnipseed*, 219 U. S. 35, 43.

The court therefore held that the presumption created by the statute of Louisiana had no relation in experience to the general facts, and therefore was an invalid exercise of legislative power and that the statute was void under the Constitution of the United States.

In the case of *Bailey* v. *State of Alabama*, 219 U. S. 219, there was a statute of Alabama which provided that where any person entered into a contract to render service or perform labor, and obtained money or other personal property from his employers, and without just cause and without refunding this money failed to perform such service, that the act of failure to perform the contract should be *prima facie* evidence of attempt to injure and defraud the employer. The Supreme Court in an elaborate opinion by Mr. Justice Hughes reviewed the law on this subject at great length, and after stating that it was within the general power of the Legislature to prescribe evidence and the effect of that evidence, says at p. 238:

"In the exercise of this power numerous statutes have been enacted providing that proof of one fact shall be *prima facie* evidence of the main fact in issue; and where the inference is not purely arbitrary and there is a rational relation between the two facts and the accused is not deprived of a proper opportunity to submit all the facts bearing upon the issue, it has been held that such facts do not violate the requirements of due process of law."

It is clear that under this decision the inference or presumption which can be established by legislative act from certain language used or facts proved must not be purely arbitrary but there must be a natural relation between the language or the facts and the inference or meaning sought to be drawn therefrom. The presumption or inference sought to be established must be one which will naturally flow from the language used or the fact proved.

In the case of *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61, the court, in construing a state statute, raising a presumption from certain facts lays down the rule as follows:

> "Each state possesses the general power to prescribe the evidence which shall be received and the effect which shall be given to it in her own courts, and may exert this power by providing that proof of a particular fact, or of several taken collectively, shall be *prima facie* evidence of another fact. Many exertions of this power are shown in the legislation of the several states, and their validity, as against the present objection, has been uniformly recognized, *save where they have been found to be merely arbitrary mandates or to discriminate invidiously between different persons in substantially the same situation.*" (Italics ours.)

Further citation of authorities seems unnecessary to establish a proposition so elementary in itself. The power to contract is vested in the individual. The state can provide by statute for any reasonable interpretation or presumption from the act of the individual or from the language used in the written instrument which is an evidence of a contract, and where the state does so provide, within the limitation prescribed, the language of the law is to be taken as a part of the contract of the parties acting within the state. But this does not authorize the state to take from the individual the right to

make his own contract and exercise that right for him; or to provide by statute for any inference or presumption from his language or acts which is inconsistent therewith and inconsistent with the intent which the language in its ordinary acceptation clearly expressed.

Applying these principles to the case at bar, it follows that when a check is drawn by a depositor upon a state bank or trust company of North Carolina, calling for the payment of a certain amount in dollars, it is an order on the bank for the payment upon presentation of that amount in lawful money of the United States. The Legislature of the state cannot under the pretense of a rule of construction or otherwise make this instrument payable in anything but lawful money of the United States, or force the holder thereof to take less than the face amount of the check so drawn; nor can the Legislature under its authority to establish reasonable rules of interpretation give to language which thus has a fixed and definite meaning an interpretation or meaning entirely inconsistent therewith and contradictory thereof.

It is equally clear that the provisions of such a statute cannot by implication or otherwise be read into a contract executed outside of the State of North Carolina.

In the case of *Scudder* v. *Union National Bank*, 91 U. S. 406, this court says:

> "Matters bearing upon the execution, the interpretation and the validity of a contract are determined by the law of the place where the contract is made. Matters connected with its performance are regulated by the law prevailing at the place of performance. Matters respecting the remedy, such as the bringing of suits, admissibility of evidence, statutes of limitations, depend upon the laws of the state where the suit is brought."

It is a matter of elementary law that a negotiable instrument contains many contracts. The drawer of the bill makes one contract, and each endorser makes a

separate contract. Daniel on Negotiable Instruments, Sixth Edition, page 1633, commenting upon this principle, says:

> "The drawer of a bill undertakes that the drawee shall accept, and afterward pay the bill according to its tenor, at the place and domicile of the drawee, if it be drawn and accepted generally; at the place appointed for payment, if it be drawn and accepted payable at a different place from the place of domicile of the drawee. If this contract of the drawer be broken by the drawee, either by non-acceptance or non-payment, the drawer is liable for payment of the bill, not where the bill was to be paid by the drawee, but where he, the drawer, made his contract, with his interest, damages, and costs, *as the law of the country where he endorses.*"

In the light of the above stated principles, if a depositor in a North Carolina bank were to draw and deliver a check upon a North Carolina bank to the payee in New York, the contract between the drawer and the payee would be made in New York, and its construction must depend upon the law of New York, for the construction of negotiable instruments depends upon the law of the place of contract, although the manner of performance depends upon the law of the place of payment. By drawing the instrument in New York the drawer would undertake that if it were presented in North Carolina and was not paid, he would immediately upon due notice pay the amount of the check to the holder. It could not be said that these parties in New York in using the term "dollars" could mean anything except lawful money. If the payee should endorse the check either in New York or in some other state, he would by endorsing warrant to the Federal Reserve Bank or some other endorsee that if the instrument were duly presented and were not paid according to its tenor, he would immediately reimburse the holder. It could not be said that this

endorser or his endorsee had in mind any means of payment except lawful money. If this check be presented and payment in lawful money is refused, the holder is immediately entitled to enforce against the prior endorsers and the drawer the agreements which they made in the other ~~courts~~ States. If the injunction in this case had been sustained, the holder would have been restrained from enforcing this agreement with the drawer and prior endorsers, and by arbitrary power would be compelled to release the persons with whom he had contracted and to accept the obligation of the drawee bank, when his contract with the drawer and the prior endorsers had plainly been to the effect that he should receive money from the drawee bank or from them. Our opponents contend that the manner of performance, i. e., the medium of payment contemplated in a negotiable instrument, is always governed by the law of the place of payment. This is correct, but if we regard the statute of North Carolina as an effort to define the manner of payment, it is then clearly an effort to define a legal tender. If we regard it as an effort to establish a rule for the interpretation of contracts, it cannot apply to checks which circulate outside of the State of North Carolina, for the interpretation of the terms in such checks is not regulated by the law of North Carolina.

We, therefore, submit upon this point that the holder of every check who causes it to be presented to the drawee bank in North Carolina is entitled to receive lawful money from the drawee bank; or, if it is refused, is entitled to receive lawful money from the drawer and prior endorsers. If such holder, whether it be the Federal reserve bank in its own right or some other person, is enjoined from returning the check as dishonored when payment in cash is refused and enjoined from refusing an exchange draft when tendered in payment of a check upon a North Carolina state bank, this holder is by injunction required to accept in settlement of an obli-

gation payable in money something other than money, and that any effort of the Legislature to bring out such a result is, as it was held by the Supreme Court of North Carolina, a bare and open violation of the provisions of Section 10 of Article 1 of the Constitution of the United States, prohibiting any state from making anything a legal tender for debts except gold or silver.

For the reasons stated we submit that the decision of the Supreme Court of North Carolina on this point should be affirmed.

POINT IV.

That the Act of the Legislature of the State of North Carolina (Chapter 20, Public Laws 1921) upon which complainants rely, is invalid, in that it seeks to deny to defendant the equal protection of the laws and to deprive the defendant of liberty or property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

The discussion of this point involves the consideration of the two provisions of the Fourteenth Amendment relied upon, which will be considered separately.

(1) *The Act of the Legislature of North Carolina is invalid in that it seeks to deny to the defendant the equal protection of the laws.*

The defendant contends that the Act of February 5, 1921, undertakes to single out the defendant from other banking institutions by an arbitrary and unreasonable discrimination, and thus to deny to it that equal protection of the law guaranteed by the aforesaid amendment to the Federal Constitution.

The defendant is a corporation organized under Act of Congress, and as such is authorized to do business in all of the states of the Fifth Reserve District, including the State of North Carolina, and is in legal effect a corporation in each of the states in which it is authorized to operate. It is, therefore within the jurisdiction of North Carolina within the meaning of the Amendment.

Texas, etc. Ry. Co. v. *Arncut*, 92 S. W. 57.
In re Cushing's Estate, 82 N. Y. Sup. 795.

The Fourteenth Amendment applies to all persons within the jurisdiction of the state, and it is now settled law that "persons" as used in the Amendment includes private corporations.

Quimby v. *Pennsylvania*, 125 U. S. 181, 188.

Southern Ry. Co. v. *Green*, 216 U. S. 400, 412.
Gulf &c. Ry. Co. v. *Ellis*, 165 U. S. 150.
Atchison &c. Ry. Co. v. *Matthews*, 174 U. S. 104.

The question as to what is a denial of the equal protection of the laws within the meaning of the Fourteenth Amendment has been before this court in so many cases and applied by this court to so many varying states of fact that it is no longer open to discussion. It is only necessary to get clearly in mind the principles involved and the limitations thereof, and apply the same to the facts of the particular case.

The principle is well and briefly stated by Mr. Justice Day in the case of *Southern Railway Co.* v. *Green*, 216 U. S. 400, 412, where it is said:

> "The equal protection of the law means subject to equal laws applying to all in the same situation. If the plaintiff is a person within the jurisdiction of the State of Alabama, within the meaning of the Fourteenth Amendment, it is entitled to stand before the law upon equal terms, to enjoy the same rights as belong to and to bear the same burdens as are imposed upon other persons in like situation."

In the case of *Nashville &c. Ry. Co.* v. *Taylor*, 86 Fed. 168, after an exhaustive review of the authorities, the court said:

> "What must constitute a denial of equal protection of the laws will depend in this view in a large measure upon what rights have been conferred or protection extended under the Constitution and laws of the particular state in which the question arises. As the constitutions and laws of the states vary, the proposition that each case must to an extent depend upon its own facts is specially applicable to this class of cases. When the state itself undertakes to deal with its citizens by legislation it does so under certain limitations and it may not single out a class of citizens and subject that class to oppressive discrimination, specially in respect to those rights so

important as to be protected by constitutional guaranty."

In *Cotting* v. *Goddard*, 183 U. S. 79, 46 L. Ed. 92, the court in an opinion by Justice Brewer cites with approval the definition attempted or given by Cooley:

> "Every one has a right to demand that he be governed by general rules, and a special statute, which, without his consent, singles his case out from one to be regulated by different law from that which is applied in all similar cases, would not be legitimate legislation, but would be such an arbitrary mandate as is not within the province of free governments. Those who make the laws are to govern by promulgated, established laws not to be varied in particular cases, but to have one rule for rich and poor, for the favorite at court and the countryman at the plow. This is the maxim in Constitutional Law and by it we may test the authority and binding powers of legislative enactments."

In *Sunday Lake Iron Company* v. *Wakefield*, 247 U. S. 350, 62 L. Ed. 1154, the court, in an opinion by Justice McReynolds, says:

> "The purpose of the equal protection clause of the Fourteenth Amendment is to secure every person within the state's jurisdiction against intentional and arbitrary discrimination, whether occasioned by express terms of a statute or by its improper execution through duly constituted agents."

See also the following authorities stating and illustrating this principle:

Barbier v. *Connelly*, 113 U. S. 27, 31;
Truax v. *Raich*, 239 U. S. 33;
Truax v. *Connelly*, 66 Law ed. U. S. Rep. 132;
Yick Wo v. *Hopkins*, 118 U. S. 356;
Smith v. *Texas*, 233 U. S. 630;
Gulf &c. Ry. Co. v. *Ellis*, 165 U. S. 150.
M. K. & T. R. R. Co. v. *Cade*, 233 U. S. 642;
Missouri v. *Louis*, 101 U. S. 22;

Atchison etc. R. R. Co. v. *Matthews,* 174 U. S. 96;
Cotting v. *Kansas City Stock Yards,* 183 U. S. 110;
Connelly v. *Union Sewer Pipe Co.,* 184 U. S. 540, 559;
Union Co. Nat. Bank v. *Ozan L. Co.,* 127 Fed. 212.

It is admitted, of course, that under the decisions of this Court construing this provision of the Fourteenth Amendment, it is competent for the states to make reasonable classifications of persons, and to legislate within the scope of its police power with respect to the classifications so made so long as such classifications have a reasonable basis in fact and experience, and there is no discrimination between the persons or corporations of the several classes so established. There have been so many decisions in which this branch of the subject has been considered and the principles applicable thereto applied, that we shall not undertake to cite or review them all, but shall refer the court to only some of the leading decisions, illustrating and applying this principle.

In the case of *Gulf &c. Ry. Co.* v. *Ellis,* 165 U. S. 150, this subject is discussed in an elaborate opinion by Mr. Justice Brewer. There was a statute of the State of Texas which provided that any person having a *bona fide* claim against a railway company for labor done, damages, overcharges, stock killed, &c., and the amount does not exceed $50, might present the same to a railroad agent and if the claim was not paid within thirty days he might immediately institute suit thereon, and if he recovered the amount claimed he should recover all costs and in addition thereto an attorney's fee not to exceed $10. The court held that this statute was unconstitutional in that it undertook to segregate railroad companies and enforce upon them conditions as to the payment of their debts which were not in force as against other debtors. In disposing of the question, the court, at p. 153, says:

"The Supreme Court of the state considered

it is presented to us for consideration. Considered as such, it is simply a statute imposing a penalty upon railroad corporations for a failure to pay certain debts. No individuals are thus punished, and no other corporations. The act singles out a certain class of debtors and punishes them when for like delinquencies it punishes no others. They are not treated as other debtors, or equally with other litigants under like conditions and with like protection. If litigation terminates adversely to them, they are mulcted in the attorneys' fees of the successful plaintiff; if it terminates in their favor they recover no attorney's fees. It is no sufficient answer to say that they are punished only when adjudged to be in the wrong. They do not enter the courts upon equal terms. They must pay attorney's fees if wrong; they do not recover any if right; while their adversaries recover if right and pay nothing if wrong. In the suits, therefore, to which they are parties they are discriminated against, and are not treated as others. They do not stand equal before the law. They do not receive its equal protection. All this is obvious from a mere inspection of the statute.

"It is true the amount of the attorney's fee which may be charged is small, but if the state has the power to thus mulct them in a small amount it has equal power to do so in a larger sum. The matter of amount does not determine the question of right, and the party who has a legal right may insist upon it, if only a shilling be involved. As well said by Mr. Justice Bradley in *Boyd* v. *United States*, 116 U. S. 616, 635: 'Illegitimate and unconstitutional practices get their first footing in that way—namely, by silent approaches and slight deviations from legal modes of procedure. This can only be obviated by adhering to the rule that constitutional provisions for the security of person and property should be liberally construed. A close and literal construction deprives them of half their efficacy, and leads to gradual depreciation of the right, as if it consisted more in sound than in substance. It is the duty of courts to be watchful for the consti-

tutional rights of the citizens and against any stealthy encroachments thereon. Their motto should be *obsta principiis.*'

"While good faith and a knowledge of existing conditions on the part of a legislature is to be presumed, yet to carry that presumption to the extent of always holding that there must be some undisclosed and unknown reason for subjecting certain individuals or corporations to hostile and discriminating legislation is to make the protecting clauses of the Fourteenth Amendment a mere rope of sand, in no manner restraining state action."

And again at page 157 the court said:

"It is, of course, proper that every debtor should pay his debts, and there might be no impropriety in giving to every successful suitor attorney's fees. Such a provision would bear a reasonable relatio to the delinquency of the debtor and would certainly create no inequality of right or protection. But before a distinction can be made between debtors, and one be punished for a failure to pay his debts, while another is permitted to become in like manner delinquent without any punishment, there must be some difference in the obligation to pay, some reason why the duty of payment is more imperative in the one instance than in the other."

In the case of *Atchison, &c., Ry. Co.* vs. *Matthews*, 174 U. S. 96, the court was again called upon to consider this subject with reference to a statute of the State of Kansas, providing for recovery in action for damages by fire set out by the railroad company and allowing a reasonable attorney's fees where the recovery was had. In an opinion by Mr. Justice Brewer, the court again views the principles and authorities involved at great length, and sustains the validity of the statute, distinguishing the case from that of *Gulf, &c., R. R. Co.* v. *Ellis, supra*, upon the ground that whereas the statute held invalid in the Ellis case undertook to impose attorney's fee by way of penalty for the payment of railway debts, which penalty was not applied to other persons owing similar debts, in this case the penalty was applied for the

negligence of the railroad company in setting out the fire, and therefore the basis of classification was legitimate, since the railway company being engaged in a peculiarly hazardous business and the classification prescribed in the statute applied to all those engaged in this business, it constituted a legitimate business for such classification. In explaining the principles applicable to such cases and the distinction there applied by the court, the Supreme Court, pp. 104 and 105, after laying down the principle that the Legislature of a state will not be lightly held to be one transcending its power, says:

> "On the other hand, it is also true that the equal protection guaranteed by the Constitution forbids the legislature to select a person, natural or artificial, and impose upon him or it burdens and liabilities which are not cast upon others similarly situated. It cannot pick out one individual, or one corporation, and enact that whenever he or it is sued the judgment shall be for double damages, or subject to an attorney fee in favor of the plaintiff, when no other individual or corporation is subjected to the same rule. Neither can it make a classification of individuals or corporations which is purely arbitrary, and impose upon such class special burdens and liabilities. Even where the selection is not obviously unreasonable and arbitrary, if the discrimination is based upon matters which have no relation to the object sought to be accomplished, the same conclusion of the unconstitutionality is affirmed. *Yick Wo* vs. *Hopkins, supra*, forcibly illustrates this. In that case a municipal ordinance of San Francisco, designed to prevent the Chinese from carrying on the laundry business was adjudged void. This court looked beyond the mere letter of the ordinance to the conditions of things as they existed in San Francisco, and saw that under the guise of regulation an arbitrary classification was intended and accomplished."

In the case of *Southern Ry. Co.* v. *Green*, 216 U. S. 400, the Legislature of Alabama undertook to impose a special franchise tax on foreign corporations doing busi-

ness in that state which was not imposed on domestic corporations. The Supreme Court held this statute to be unconstitutional as a violation of the equal protection of the laws of the Fourteenth Amendment. We have already quoted from this case language pertinent to the point under discussion, and the review of the authorities in the opinion by Mr. Justice Day is most instructive as to the principles which guide the court in dealing with statutes of this character.

In the case of *Smith* v. *Texas*, 233 U. S. 630, there was a statute of Texas which provided that no person could be employed as a conductor on a passenger train who had not served two years as a brakeman or conductor of a freight train, and prescribing other qualifications for employment. The court held that this statute was invalid as constituting a purely arbitrary basis of classification, and as denying to all persons however competent, who had not rendered this particular service the right to employment in this line of business. In the opinion by Mr. Justice Lamar the right of the state to prescribe qualifications for employment in business of this character in the exercise of its police power was recognized, but in concluding the discussion, at p. 641, the court says:

> "3. So that the case distinctly raises the question as to whether a statute, in permitting certain competent men to serve, can lay down a test which absolutely prohibits other competent men from entering the same private employment. It would seem that to ask the question is to answer it—and the answer in no way denies the right of the state to require examinations to test the fitness and capacity of brakemen, firemen, engineers and conductors to enter upon a service fraught with so much of risk to themselves and to the public. But all men are entitled to the equal protection of the law in their right to work for the support of themselves and families. A statute which permits the brakeman to act—because he is presumptively competent —and prohibits the employment of engineers and all

> others who can affirmatively prove that they are likewise competent, is not confined to securing the public safety, but denies to many the liberty of contract granted to brakemen and operates to establish rules of promotion in a private employment."

The case of *Missouri, &c., Ry. Co.* v. *Cade*, 233 U. S. 642, involved the construction and the validity of a statute of the State of Texas providing for allowing all attorney's fees in cases of recovery for services rendered, material furnished and other similar charges against any person or corporation doing business in the State. It will be observed that this statute was only a modification of the statute held unconstitutional in the case of *Railroad Company* v. *Ellis, supra*. In that case the statute was limited to claims against railroad companies. In this case the statute is applied to *all persons* having claims of the character listed therein. The appellant relies upon the Ellis case. The court in reviewing the Ellis case said that the former statute was held invalid in that it singled out a particular class of debtors, and imposed the burden upon them without any reasonable ground existing for the discrimination. "The classification was held to be arbitrary because having no relation to the special privileges granted to this class of corporations or to the peculiar feature of their business."

The court, in holding the statute under review to be valid, at p. 649, said:

> "The present statute, however, differs in essential features. It applies to claims 'against any person or corporation doing business in this state, for personal services rendered or for labor done, or for material furnished, or for overcharges on freight or express, or for any claim for lost or damaged freight, or for stock killed or injured by such person or corporation, its agents or employes.' There is here no classification of debtors; the act bears equally against individuals and against corporations of any class doing business in the state. It applies only to certain kinds of claims; but these cover a wide range, and do not appear to have been

grouped together for the purpose of bearing against any class or classes of citizens or corporations. Unless something of this sort did appear, we should not be justified in holding the act to be repugnant to the Fourteenth Amendment."

In the recent case of *Chicago &c. Ry. Co.* v. *Nye Schneider Fowler Co.*, decided at this term (Advance Sheets Dec. 1, 1922, p. 46), this court, in an opinion by Mr. Chief Justice Taft, after an extensive review of cases on this subject, said:

> "It is obvious that it is not practical to draw a line of distinction between these cases, based on a difference of particular limitations in the statute and the different facts in particular cases. The court has not intended to establish one, but only to follow the general rule that when, in their action and operation in the cases before it, such statutes work an arbitrary, unequal, and oppressive result for the carrier which shocks the sense of fairness the 14th Amendment was intended to satisfy in respect of state legislation, they will not be sustained."

Among other cases illustrating and applying this principle are the following:

Truax v. *Raich*, 239 U. S. 33;
Missouri Pacif. Ry. v. *Humes*, 115 U. S. 512;
Barbier v. *Connolly*, 113 U. S. 27;
Seaboard Air Line Ry. Co. v. *Seegers*, 207 U. S. 73;
Union Terminal Company v. *Turner Construction Co.*, 247 Fed. 727 (in which the Ellis and Cade cases are considered and distinguished).
Connolly v. *Union Sewer Pipe Co.*, 184 U. S. 540, 559.
Cotting v. *Kansas City Stock Yards Co.*, 183 U. S. 110;
Lindsley v. *Natural Carbonic Gas Co.*, 220 U. S. 61;
Fidelity, &c., Co. v. *Mettler*, 185 U. S. 325;
Truax v. *Connelly*, 66 Law Ed. U. S. Rep. 132.

Applying the principles and rules of distinction as to classification under this amendment stated and illustrated in the authorities cited, it would seem obvious that

the statute of North Carolina now under consideration violates the constitutional provision, in that it seeks to deny to the defendant the exercise of the rights accorded to other similar corporations, and to segregate the defendant into a class alone and impose upon it the burdens not imposed upon other persons and corporations.

Taking the statute as a whole, its obvious and admitted purpose is to deny to the defendant the right to collect checks drawn upon the state banks and trust companies of North Carolina when the same are presented by the defendant at the counter of the bank or through the mails or through an express company, while other banking institutions engaged in the collection of checks are permitted to make such collections without being subject to the limitation prescribed by this Act.

There is no sound or reasonable basis in fact or experience for classifying the defendant or a postoffice or express company with respect to the *business of collection of checks* in a classification different from any other person or corporation engaged in this business. The duty of a bank is to pay the check of its depositor in cash when presented at its counter. It is a matter of no consequence to the bank by whom such check is presented, so long as the person presenting the same is the lawful holder in due course and entitled to receive the proceeds thereof either as holder of such check or as his agent. It can make absolutely no difference in fact to the drawee bank whether the check be presented for payment at the counter by a local merchant, a local banking institution or the Federal Reserve Bank. All the drawee bank has to do is to pay the check in cash or decline to pay it, and this duty or right is the same, it matters not by whom it is presented.

Notwithstanding this fact, this statute undertakes to place the Federal Reserve Bank in a separate and distinct class and to impose upon it certain restrictions and limitations not imposed on anyone else presenting checks for collection. Since neither the postoffice nor

express companies are engaged in the business of collecting checks to any extent, it is obvious that the purpose of including them in the statute was to prevent The Federal Reserve Bank from presenting checks through these agencies instead of directly and thus to make effective the effort to put that institution in a class separate and distinct from all other persons collecting checks.

Since by the Federal law the Federal Reserve Bank is prohibited from paying exchange and the statute undertakes to give to the state banks the right to refuse payment of a check unless exchange is allowed for remittance, it in effect undertakes to deny to the Federal Reserve Bank the right to collect checks in cash. But the Act goes further, and not only denies to the Federal Reserve Bank the right to collect checks in cash, which right is accorded to all persons and institutions, but it expressly provides that where the check is presented by the Federal Reserve Bank or its agent, then it may be payable not in cash as called for by its terms, but in exchange drawn on the reserve deposits of the drawee bank. If this statute be valid, any person or banking institution within or without the State of North Carolina who holds a check on one of the plaintiff banks may present the same and collect cash, but if it is presented through the Federal Reserve Bank, the drawee is given the right to tender in payment another check instead of lawful money of the United States. This is clearly a direct effort to discriminate against the Federal Reserve Bank in the collection of checks on the banks of North Carolina both as to the right of collection and as to the medium in which the same will be paid.

What possible basis is there to sustain such a discrimination or classification with respect to the collection of checks? It is admitted that in other departments of its business the Federal Reserve Bank is different in some particulars from other banking institutions. It is admitted that it has powers which other banking institutions have not. But in the daily business of collecting checks its duties and obligations are exactly the same as

those of other persons or corporations engaged in the same business, or who may have checks for collection. The distinctions laid down in the cases of *Railroad Company* v. *Ellis; Railway Co.* v. *Cade; Atchison, &c., Ry.* v. *Matthews*, and other cases cited *supra*, are directly applicable. In these cases it was held that a statute which imposed an attorney's fee upon railways and not upon other debtors as a penalty for the failure to pay a debt for labor done or material furnished was a discrimination against railway companies and invalid; while a statute which imposed a similar attorney's fee upon *all persons* for failure to pay debts of the classes named was valid. The Supreme Court held that there was no logical basis for a discrimination in the matter of payment of debts between railway companies and any other debtor, but it also held that there was a basis for a discrimination in matters relating to the setting out of fires, fencing of tracks and similar transactions of the railway company as to which it was engaged in a specially hazardous business and was by fact and experience in a different position from the ordinary citizens of the community.

In the same manner, there may be some basis for difference between ordinary banking institutions or individuals and the Federal Reserve Bank with respect to certain of its powers, duties or actions, but as to the manner of collecting checks, it is merely the holder of an obligation representing a debt which the debtor has promised shall be paid by the bank if that obligation is duly presented, and there is no distinction between the obligation itself or the rights or duties of the drawee bank which can be based upon the fact of its being presented through the Federal Reserve Bank or any other person, corporation, or institution engaged in the collection of checks any more than there is a just basis for distinction between debtors owing money for labor done or material furnished.

It is submitted, therefore, that under the decisions of this Court cited above, and the principles therein laid down, there is no just and reasonable basis for the dis-

crimination in this matter against the defendant, the Federal Reserve Bank, or for a classification of the defendant in a class different from other persons, banks or institutions collecting checks; that the discrimination sought to be made by the Act of the Legislature of North Carolina is clearly unreasonable and arbitrary, and therefore in violation of the equal protection clause of the Constitution of the United States.

Counsel for petitioners have undertaken on page 27 of their opening brief in this Court to indicate certain grounds for the classification of Federal Reserve Banks in a class distinct from all other banking institutions engaged in the collection of checks. The several grounds indicated by them for this classification will be noted and considered briefly.

(1) *That the Act of Congress under which the Federal Reserve Banks are created places them in a class distinct from ordinary commercial banks.*

This is true in certain aspects of their business. They are fiscal agents of the government for the performance of certain public duties, and are vested with certain other powers and charged with certain other obligations which are not common to national banks or general commercial banking institutions. But in the *collection of checks*, which is the matter in controversy in this case, the Federal Reserve Banks occupy the same position and have the same legal rights as ordinary commercial banks or any other holder of a check, except that they are subject to the limitation that they cannot allow charges for exchange, which it is the right of every holder of a check to refuse to pay. In the discharge of these functions they are in direct competition with other banking institutions and engaged in a business which is common to all banks.

(2) *That on account of their great size they constitute a distinct class.*

Size is not a basis for classification under the 14th

Amendment. The size of these banks does not affect the principles applicable to their transaction of the business of the collection of checks in any manner whatever. They occupy exactly the same position as other commercial banks in transacting this business.

(3) *That they have undertaken the function of clearing houses.*

The clearance of checks of their depositors through the Federal Reserve Banks is merely an incident of the collection of checks and does not differ in any respect from similar transactions by commercial banks. Large national or commercial banks clear checks for their depositors and discharge this function in exactly the same manner as Federal Reserve Banks.

(4) *That by the "Par Clearance" campaign they had obtained a virtual monopoly of the clearance business.*

The so-called "Par Clearance" campaign was nothing whatever but notice to their customers and other banks that the Federal Reserve Banks were prepared under the Federal Law to collect checks. In giving this notice they advertised their facilities exactly as commercial banks advertise their facilities for the collection of checks and the transaction of banking business. If, by virtue of superior facilities, they can obtain in competition larger proportion of the business than certain other banks, this is no ground for classification of these banks in a class different from other banks engaged in the same business and employing the same methods.

(5) *That they are the only corporations in the United States engaged in a par clearance campaign.*

As we have stated, the "par clearance" campaign was nothing but notice to customers that they were prepared to collect checks. Every bank advertises its facilities in this respect, and the "par list" referred to in

this suit is nothing but a statement of the terms on which the Federal Reserve Bank can make such collections. Every commercial bank undertakes to secure business by offering favorable terms for collection, and is engaged in doing exactly the same thing as a Federal Reserve Bank.

(6) *That they were the only corporations threatening State banks with the evil of presenting their checks over the counter and demanding payment in cash.*

A check being an order for the payment of money upon presentation, the presentation thereof at the counter of the drawee bank is the primary and strictly legal method of collection. Every commercial or other bank engaged in the collection of checks does and is required to do the same thing unless by mutual arrangement some other method is followed for the convenience of the parties. The great weight of authority in this country is that it is the duty of a collecting bank as a holder of a check to have the check presented to the drawee bank through some other agency and not send it direct to the drawee bank, and this has been expressly held in the State of North Carolina.

See *Bank of Rocky Mount* v. *Floyd*, 142 N. C. 408.

The Federal Reserve Bank has been ready and willing to do what other commercial banks do for convenience, that is to enter into an agreement with the drawee state banks in North Carolina, complainants in this case, to accept remittance in payment of checks by satisfactory drafts on reserve deposits, if such remittance be made at par. But if the complainant banks are unwilling to make this voluntary agreement, then the Federal Reserve Bank in collecting these checks is only doing what every other bank under similar circumstances is required to do, and this constitutes no basis for discrimination or classification.

For the reasons stated, we submit that the Act of the

Legislature of North Carolina of February 5, 1921, is unconstitutional in that it seeks by arbitrary classification to place defendant, Federal Reserve Bank, in a class distinct from other banks engaged in the same business, and clearly denies to the defendant, Federal Reserve Bank, that equal protection of the laws guaranteed to it by the 14th Amendment to the Constitution of the United States.

2. *The Act of the Legislature of North Carolina is invalid, in that it seeks to deprive the defendant of liberty and property without due process of the law, in violation of the first section of the 14th Amendment of the Constitution of the United States.*

It is probable that no one provision of the Constitution of the United States with the possible exception of the Commerce Clause, has been the subject of so many decisions as the provision of the Fourteenth Amendment against depriving any person of life, liberty or property without due process of law. To undertake a review of the decision on this subject would involve the writing of a treatise on constitutional law.

The essential principles involved are comparatively simple. Under its police power every state may impose such reasonable limitations upon the exercise of liberty and the use and enjoyment of property as may be necessary in the protection of health, morals and welfare of its people; but this power on the part of the states is always subject to the limitations of the Constitution of the United States, and if, under color of the exercise of the police power, the state undertakes to deprive any person of life, liberty or property, or to arbitrarily restrain or limit the exercise of these fundamental rights, then the action of the state through whatever agency this result may be accomplished, will be held to be invalid as in violation of the constitutional provision. A reference to a few leading decisions in this Court con-

struing and applying this provision of the Constitution will be sufficient for the purpose of this case.

In the case of *Smith* v. *Texas*, 233 U. S. 630, the Supreme Court said:

> "1. Life, liberty, property and the equal protection of the law, grouped together in the Constitution, are so related that the deprivation of any one of those separate and independent rights may lessen or extinguish the value of the other three. In so far as a man is deprived of the right to labor his liberty is restricted, his capacity to earn wages and acquire property is lessened, and he is denied the protection which the law affords those who are permitted to work. Liberty means more than freedom from servitude, and the constitutional guarantee is an assurance that the citizen shall be protected in the right to use his powers of mind and body in any lawful calling."

The law is well settled that the terms "liberty" and "property" as used in this constitutional amendment embrace the right of contract as an element of liberty and a valuable property right, and the right to labor in any lawful employment, and both are under the protection of the constitutional provision.

In the case of *Allgeyer* v. *Louisiana*, 165 U. S. 578, the court was passing upon a statute of the State of Louisiana which undertook to prohibit any person from effecting insurance on property or marine insurance in the state in any company which had not complied with the laws of the state. A contract of marine insurance was effected in the State of New York, and notice of the completion of the contract was given by mail in the State of Louisiana. The court held the statute of Louisiana invalid as being in violation of the constitutional provision. In speaking of the term "liberty" as used in the Constitution, the court said:

> "The liberty mentioned in that amendment means not only the right of the citizen to be free from the mere physical restraint of his person, as by incarceration, but the term is deemed to embrace the right of the citizen to be free in the enjoyment of all his faculties; to be free to use them in all lawful ways; to live and work where he will; to earn his livelihood by any lawful calling; to pursue any livelihood or avocation, and for that purpose to enter into all contracts which may be proper, necessary and essential to his carrying out to a successful conclusion the purposes above mentioned."

In the case of *Lochner* v. *New York*, 198 U. S. 45, there was a statute in the State of New York which undertook to regulate the hours of labor in bakery. The court held that this statute was unconstitutional as an arbitrary invasion of the right of every citizen to sell and purchase labor. The court recognized the right of the state to establish reasonable regulations for the protection of the health of its citizens, but held that the Act in question was an arbitrary invasion of the constitutional rights of the citizens of New York. At p. 56 the court says:

> "In every case that comes before this court, therefore, where legislation of this character is concerned, and where the protection of the Federal Constitution is sought, the question necessarily arises: Is this a fair, reasonable and appropriate exercise of the police power of the state, or is it an unreasonable, unnecessary and arbitrary interference with the right of the individual to his personal liberty or to enter into those contracts in relation to labor which may seem to him appropriate or necessary for the support of himself and his family? Of course, the liberty of contract relating to labor includes both parties to it. The one has as much right to purchase as the other to sell labor."

In *Coppage* v. *Kansas*, 236 U. S. 1, a statute of the

State of Kansas undertook to make it a misdemeanor for an employer to require an employee to agree not to become or remain a member of a labor union. The court held that this statute was invalid as an unwarranted invasion of the right of contract. After laying down the principle that when an appeal is made to the Supreme Court for the protection of rights under the Constitution, the decision depends not upon the form of the statute but upon its operation and effect as applied and enforced, the court, in an opinion by Mr. Justice Pitney, reviewed at length the rights of the states to regulate and control the life, liberty and property of their citizens under the police power, and holds that this right is always subject to the constitutional limitations which cannot be avoided or evaded. At p. 14 the court says:

> "The principle is fundamental and vital. Included in the right of personal liberty and the right of private property—partaking of the nature of each—is the right to make contracts for the acquisition of property. Chief among such contracts is that of personal employment, by which labor and other services are exchanged for money or other forms of property. If this right be struck down or arbitrarily interfered with, there is a substantial impairment of liberty in the long-established constitutional sense. The right is as essential to the laborer as to the capitalist, to the poor as to the rich; for the vast majority of persons have no other honest way to begin to acquire property, save by working for money."

Again at p. 17 the court after declaring that the provision of the Fourteenth Amendment recognizes liberty and property as coexistent human rights, and bars the states from any unwarranted interference with either, says:

> "And since a state may not strike them down directly it is clear that it may not do so indirectly,

as by declaring in effect that the public good requires the removal of those inequalities that are but the normal and inevitable result of their exercise, and then invoking the police power in order to remove the inequalities, without other object in view. The police power is broad, and not easily defined, but it cannot be given the wide scope that is here asserted for it, without in effect nullifying the constitutional guaranty."

See also in further illustration of these principles:

Miller v. *Wilson*, 236 U. S. 373;
Knoxville Iron Co. v. *Harberson*, 183 U. S. 22.
Lamb v. *Powder Co.*, 132 Fed. 439.
Adkins, et al., vs. *Children's Hospital*, decided April 9th, 1923.

These authorities are sufficient to establish and illustrate the essential principles for which we contend, and it is useless to weary the court with the citation of additional cases to be found throughout the reports, many of which are referred to in the opinion in the above cases. Summarizing the effect of these decisions, we submit that they establish beyond controversy the following propositions:

That life, liberty and property are so inter-related that the undue or arbitrary limitations of the one necessarily constitutes a limitation of all, and deprives the citizen of those inalienable rights protected by the Constitution of the United States.

That the right of contract and of labor or service is an essential part of the liberty safeguarded by the constitutional amendment.

That the right of contract, and the right to labor are in themselves property, and that any Act of the state which unduly limits these rights necessarily deprives the citizen of property.

It requires no citation of authority to establish the

proposition that the due process of law required by the Constitution is that orderly proceeding incident to the jurisprudence established in this country, and is not met by a mere legislative act.

The state is allowed a wide discretion in the exercise of its police power in imposing limitations upon the enjoyment of life, liberty and property for the protection of the health, morals and welfare of its citizens. But where the limitations imposed or the act depriving the citizen of these essential rights is not in any direct or reasonable way related to the protection of health, morals or the welfare of the people, then any act seeking arbitrarily to restrain the enjoyment of these rights is a violation of the constitutional amendment.

Applying these principles to the case at bar, it is clear that by Act of Congress the defendant, a federal corporation, has been authorized to engage in the business of the collection of checks payable upon presentation within its district, a business common to all banking institutions. The right to exercise this authority and to engage in this business is a valuable property right. While the Federal Reserve Bank has never made any charge for such collections, it has the right to do so under the law should the occasion arise when it would be desirable, and, therefore, to make this branch of its business an important source of revenue.

The exercise of this authority and the conduct of this business is subject to the limitation imposed by Congress, that it shall not pay any charge for exchange in the remission or payment of checks, which would be its legal right in the absence of statute.

In order to exercise this authority and to engage in this business it is essential that the Federal Reserve Bank for its protection shall have the right as other commercial banks to present checks coming into its possession for collection at the counter of the drawee bank and demand payment thereof in lawful money. In effect the

Act of the Legislature of North Carolina, if valid, prohibits the exercise of this fundamental legal right common to all persons into whose possession checks may come for collection, since it seeks to require the Federal Reserve Bank to accept in payment of such checks exchange drafts of the drawee banks, drawn on their reserve deposits, and the bill in this case seeks to enjoin the defendant from refusing to accept such exchange drafts in payment thereof. This is an effort to deny to the Federal Reserve Bank a valuable property right conferred by Congress, and to deprive the Federal Reserve Bank of this valuable property right in violation of the 14th Amendment to the Constitution of the United States.

But the Act, if valid, goes even further. As we have pointed out, and it is admitted, if the Act of the Legislature of North Carolina be valid, and the Federal Reserve Bank is compelled to accept exchange drafts in payment of checks, if it attempts to collect them at all, then the drawee bank and other state banks in North Carolina can defeat entirely the collection of the check by giving exchange drafts on other banks in North Carolina, which in turn would be payable in exchange drafts; and the Federal Reserve Bank would be unable therefore to obtain lawful money in payment of said checks. The effect of the statute, if valid, therefore, is to deny to the Federal Reserve Bank the right to collect checks on state banks of North Carolina, which right was expressly given it by the Act of Congress, and to deprive it of this valuable property right in violation of the Fourteenth Amendment to the Constitution of the United States. It is idle for the Federal Reserve Bank to have authority to receive checks for collection if the statute of North Carolina can deny to that bank the right to demand money in payment.

The Federal Reserve Bank is authorized to receive and collect checks on state banks of North Carolina, and

as an incident thereto to contract with those banks for the payment of such checks in the due course of business, so as to make its collection facilities attractive to its customers in competition with other banks, or in event of failure or refusal of the drawee banks to pay the checks upon presentation to have the same dishonored in order to protect its contract right against the drawers and endorsers of said checks. The Act of the State of North Carolina, if valid, deprives the Federal Reserve Bank of the right to contract with the drawee banks with respect to the collection or payment of checks, fixes the medium which the Federal Reserve Bank *must accept* as an exchange draft drawn on the reserve deposits of the drawee bank whether good or bad, and denies to the Federal Reserve Bank the right to protest the check for non-payment, if such non-payment was because of the refusal of the Federal Reserve Bank to allow exchange, which it is forbidden by Act of Congress to allow. The effect of the Act, if valid, therefore, is to deprive the Federal Reserve Bank of a valuable right and liberty of contract, in effect to deprive defendant bank of an important business which it cannot conduct under such limitations, and thus to deprive it of liberty and of property rights of great value, in violation of the 14th Amendment of the Constitution of the United States.

We submit, therefore, that the Act of the Legislature of North Carolina is invalid as being in violation of the 14th Amendment to the Constitution of the United States, in that it seeks to deprive the defendant of liberty or property without due process of law.

CONCLUSION.

For the reasons stated, we respectfully submit that the decision of the Supreme Court of North Carolina, holding the Act of the Legislature of North Carolina of February 5, 1921, invalid, reversing the decision of the

Superior Court of Union County, dissolving the injunction theretofore granted by that court in this cause and dismissing the complaint, is clearly right and should be affirmed.

Respectfully submitted,

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